

# **“Constructing a New Socialist Countryside” in Contemporary China: Strategic Groups and Institutional Change**

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## **Abbreviations**

CBE	Commune and Brigade Enterprise
CCP	Chinese Communist Party
CMEs	Coordinated Market Economies
CNSC	Construction of a New Socialist Countryside
CSR	Corporate Social Responsibility
EPBs	Economic Planning Boards
GDP	Gross Domestic Product
GNP	Gross National Product
LMEs	Liberal Market Economies
MITI	Ministry of International Trade and Industry
MOFCOM	Ministry of Commerce
NDRC	National Development and Reform Commission
NICs	Newly Industrializing Countries
NPC	National People's Congress
SDPC	State Development Planning Commission
SETC	State Economic and Trade Commission
SEZs	Special Economic Zones
SOE	State Owned Enterprise
TVE	Township and Village Enterprise



# Chapter 1. Introduction: Explaining Institutional Change

## 1.1 Preamble

China's economy has experienced staggering growth since implementing economic reforms. Between 1978 and 2006, for instance, China's Gross Domestic Product (GDP) increased at an average rate of 9.8% per year after adjusting for inflation (Xie and Wang, 2009). However, accompanying the remarkable economic growth since 1978, a sharp rise in economic inequality has intensified social inequality and conflict across regions and social groups. In particular, the issue of farmer poverty and rural polarization have challenged the Chinese Communist Party (CCP) leadership and subsequently become the focus of its social policy agenda.

In response to the social risks and challenges induced by income inequality (Thøgersen, 2011, p.175), the central state, under Hu Jintao's leadership, initiated a far-reaching social policy exclusively implemented in the Chinese countryside in 2006, called the "Construction of a New Socialist Countryside" program (*shehui zhuyi xin nongcun jianshe*, hereafter abbreviated to CNSC).<sup>1</sup> Employing a sociological perspective, this study seeks to analyze how central Chinese social policy is implemented on the ground. Guided by this general perspective, this study examines a number of institutions that have been changing for more than one decade and that are involved with society, economic and political power, the high fluidity of private ownership, the authority vested in jurisdiction, administrative and political officials, the establishment of new types of enterprises, the contention over poverty, land use

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<sup>1</sup> Five key points were written into CNSC: (1) Balance urban and rural development; (2) Develop modern agriculture; (3) Deepen rural reform (4) Improve rural public services; and (5) Increase peasants' income. See *Dierpian: jianshe shehui zhuyi xinnongcun* (Chapter Two of Outline of the Eleventh Five-Year Plan (2006-2010): Constructing a New Socialist Countryside). Website of Chinese government. [http://www.gov.cn/jtzt/2006-03/16/content\\_228841\\_3.htm](http://www.gov.cn/jtzt/2006-03/16/content_228841_3.htm) (accessed 5 October 2015). For more detailed studies on CNSC, see Ahlers and Schubert (2009); He and Li (2006); Schubert and Ahlers (2012); Su (2009) and Thøgersen (2009, 2011).

and environment degradation. It also involves the paradox of huge affluence and impoverishment, of state intervention to regulate the social consequences of growth-based development. By its nature, this study further integrates interlinking social, political and economic institutions that are in rapid transition.

This study uses empirical evidence from the micro level, i.e. small towns in a county in Shaanxi Province, and theoretical approaches from the political economy field to harness these multiple dimensions. It will show that various groups of people acting within certain constraints and the institutional dynamics are changing social and political structures in localities. The interplay between local official, coal mine owners and villagers in terms of poverty alleviation frames the Corporate Social Responsibility (CSR) policy.

In fact, the original idea of this study was to examine CSR as a symbolic form of rule that enabled voluntary compensatory transfers to villagers for their losses and interaction in relation to social traditions and norms. However, the field interviews with local cadres revealed that the issues are greater and more fundamental than just poverty reduction and CSR. What thus became the focus was the fundamental transformation of the local economy, politics and society, which I have now analyzed in the seven chapters of this dissertation. Developing on the basis of Oi's "local state corporatism" (Chapter 2) and Heberer and Schubert's "strategic group" (Chapters 2 and 5) that provide a set of concepts for analysis, I have applied and contributed to these theoretical and analytical frameworks by examining the roles of local officials and coal mine owners and villagers.

This chapter focuses on the introduction of the study and offers an explanation of institutional change. It is organized in three parts. The first section presents the research background, research questions, research design and methodology. The second section describes the region of Fugu County. The last section deals with the structure of the dissertation.

## 1.2 Research Background

China has undergone dramatic institutional changes following its rapid socioeconomic transformation since the initiation of economic reforms in 1978, which simultaneously marked a transition from agriculture to industry and from a socialist planned economy to a market economy. However, such economic reforms marked by price realignment, resource reallocation, and spatial restructuring are bound to produce income shifts across regions and social groups, and therefore usually result in a widening income gap and an intensification of social inequality and conflict (Thøgersen, 2011, p.175; Wang and Hu, 1999, p.5). In particular, “starting roughly from 1993, Chinese reform entered the second phase, which appeared increasingly like a zero-sum game” (Wang, 2000, p.374), meaning some social groups gained at the expense of others. Among all the social groups, the farmers are viewed as the most disadvantaged group as they benefited least from the recent reforms. 80% of Chinese farmers have an income below the national average of farmers’ incomes. In other words, the top 20% of rural residents have a much higher income than the rest of rural residents (Wang, 2000, p.380). Furthermore, according to the identified categories of income differentials, Wang (2000) argues that the recent reforms widened the gaps between regions, urban and rural populations, and between rich and poor households in either urban or rural China (p. 387-391). Among them, the rural-urban gap is unusually large, as real urban incomes are as much as four times that of real rural incomes, including urban residents’ welfare benefits of various kinds (Wang, 2000, p. 387-391). As a consequence, farmers’ poverty issues and rural polarization have become the focus of the government’s social policy agenda, with the aim of mitigating the social risks and challenges induced by these income inequalities (Thøgersen, 2011, p.175). In general terms, governments tend to play a role in redistributing gains and cost through tax extractive systems, institutionalizing social security, welfare spending, fiscal transfer programs, and other types of compensatory programs (Wang, 2000, p.376).

As the CCP leadership’s latest approach to primarily narrowing the widening urban-

rural gap and promoting the overall development of the countryside, CNSC was officially approved and written into the 11<sup>th</sup> Five-Year Plan in 2006, which sought to provide a general guideline for developing rural China. In the political jargon this is called the “twenty-character guideline” (*ershi zi fangzhen*), referring to the five four-character statements of the policy aims: “developing production” (*shengchan fazhan*), “life in plenty” (*shenghuo kuanyu*), “civilized rural atmosphere” (*xiangfeng wenming*), “clean and tidy villages” (*cunrong zhengjie*) and “democratic administration” (*guanli minzhu*). In fact, CNSC and a number of central social policy initiatives<sup>2</sup> powerfully reflect the Chinese leadership’s strong commitment to promoting rural socioeconomic development (Ahlers and Schubert, 2009; He and Li, 2006; Schubert and Ahlers, 2012; Thøgersen, 2009, 2011), therefore, reinforce the argument that China is a developmental state (Baek, 2005; Beeson, 2009; Bolesta, 2012; Knight, 2014; Nee et al, 2007; Oi, 1999; Whiting, 2001) marked by the “growth with equity” approach (Ohnesorge 2007a; 2007b; Peng and Wong, 2004) which denotes that economic growth in China is accompanied by relative socioeconomic equity, in particular a poverty alleviation practice which has lifted a large number of people out of poverty, reflected in statistics showing a reduction from 270 million in 1978 to 27 million in 2000 (Wang, 2007, p.218-9). Furthermore, China as a developmental state is characterized by four defining features: development-oriented political leadership, an autonomous and effective bureaucracy, a production-oriented private sector and performance-oriented governance (Meyns and Musamba, 2010, p.21).<sup>3</sup>

State capacity is reflected in the policy-making process which facilitates institutional change. China’s policy-making process is typically characterized by extensive experimental programs through which central policy-makers encourage local officials

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<sup>2</sup> All policies aimed at rural development have been brought together under the heading of CNSC (Thøgersen, 2011). Major initiatives include the New Rural Cooperative Medical System (NRCMS) (*nongcun xinxing hezuo yiliao zhidu*), the enactment of the Law on Farmers’ Professional Cooperatives (*nongmin zhuan ye hezuoshefa*) in October 2006 and the adoption of a Comprehensive Rural Minimum Living Allowance System (*zuidi shenghuo baoxian zhidu*, abbreviated to *dibao*) in 2007 (Schubert and Ahlers, 2012). In practice, local governments combine CNSC with the practice of poverty alleviation, in particular in the underdeveloped areas, see Lu et al. (2010, p.39-42).

<sup>3</sup> Chapter 2 will examine the theoretical implications of a developmental state in detail.



to try out new ways of problem-solving and then feed the local experiences back into national policy formulation (Heilmann, 2008a, p.1). A distinct mode of governance, “policy experimentation under hierarchy” is regarded as highly conducive to institutional innovation because it offers an effective approach to examining the institutional factors that induce behavioral changes in a rapidly changing institutional environment (Heilmann, 2008b, p. 2-3). However, “Policy experimentation is not equivalent to freewheeling trial and error or spontaneous policy diffusion. It is a purposeful and coordinated activity geared to producing novel policy options that are injected into official policymaking and then replicated on a larger scale, or even formally incorporated into national law” (Heilmann, 2008b, p.3). CNSC, an ambitious and comprehensive central policy program, aims to affect the social, economic and political sphere in rural China, and is a perfect example of the experimentation-based policy-making process. Indeed, prior to the national inception of CNSC, some provinces and cities had already carried out initiatives at “experimental sites” (*shidian*), and developed them to the next stage by “expanding the sites” (*kuoda shidian*), which then, under the direction of the national leaders, “proceeded from site to full-scale implementation” (*youdian daomian*).<sup>4</sup>

Without question, Heilmann’s (2008b, p.10) experimentation-based policy cycle provides a sophisticated framework for explaining central-level policy making (or “policy formation”). Experimental approaches have had great political impact on local-level policy implementation. For example, “in all guidelines from province level down to the counties, the establishment of model villages is the focal point of XNCJS [CNSC] implementation” (Schubert and Ahlers, 2012, p.76-77). In short, the mode of experimentation facilitates the innovative policy instruments, rather than defining policy objectives (Heilmann, 2008a, p. 2-3). Nevertheless, given that the model policy instruments have been innovated and disseminated through extensive media coverage, high-profile conferences and study tours during the policy design period, empirical

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<sup>4</sup> Early in 2004, provinces such as Zhejiang, Hebei and Jiangxi, cities such as Beijing initiated CNSC experimental programs (Huang, 2006, p.25). The related experimental program outcomes were drawn up and published immediately after the inception of CNSC. For the detailed case studies of model experiences based on the above mentioned selected regions, see Sun and Wang (2006a; 2006b).

studies have demonstrated that the policy choice and outcome (policy implementation) varies across regions (Ahlers and Schubert, 2009; Heberer and Schubert, 2012; Schubert and Ahlers, 2012; Su, 2009). Thus, policy implementation plays an important role in capturing the nature of institutional change.<sup>5</sup> This study attempts to contribute to the literature of policy implementation that brings about institutional change, borrowing core concepts stemming from institutional economics that inform the approach to institutions taken in this study. It takes as its starting point the contention that the implementation of social policy is highly dependent on its own past, emphasizing the significance of past events and decisions as having a decisive function in shaping long term paths. Therefore, the institutional change facilitated by policy implementation is highly path dependent, and “the direction of change is determined by path dependence” (North, 1994, p. 7). As this study will show, the type of property rights, as well as economic, extractive, redistributive and mediative institutions, combine to create apparent path dependence in the implementation of CNSC.

### 1.3 Research Questions

State capacity ultimately depends on the nature of the institutions and bureaucrats that govern the economy and society (Whiting, 2001, p.1). Indeed, like all other centrally-initiated rural development programs, CNSC is eventually carried out by county and township governments. This poses three central research questions: **(1) why do variations exist in project implementation under the unified framework of national policy programs and political ideology? (2) How do local governments respond to the institutional constraints? (3) How is the centrally-initiated rural development project implemented by local governments?**

#### 1.3.1 Institutional Constraints and Incentives

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<sup>5</sup> The policy-making process consists of five stages, namely problem identification (agenda setting), policy formulation, policy adoption, policy implementation and policy monitoring and evaluation (Howlett and Ramesh, 1995).

The first question concerns the institutional environment within which the policy program is carried out. What are institutions exactly? As Douglass North puts it, “[i]nstitutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction. In consequence they structure incentives in human exchange, whether political, social, or economic” (North, 1990, p.3). The institutional factors are categorized into two groups: formal and informal institutions. Informal institutions are described as codes of behavior, conventions and customs in contrast to formal institutions, which are rules that are provided in written form (North, 1990, p.4). The formal and informal institutions determine the incentives of and the constraints on policy players, while influencing their behavior and shaping policy outcomes, which in turn lead to new institutions (Greif, 2006, p.379; Whiting, 2001, p.16). Moreover, “[t]he degree to which there is an identity between the objectives of the institutional constraints and the choices individuals make in that institutional setting depends on the effectiveness of enforcement” (North, 1994, p.2). In short, whether CNSC is effectively implemented is contingent on various institutional factors, such as incentives, political constraints, severity of budget constraints and the particular configuration of resource endowments, skills of local leadership and subordinates. Among them, fiscal constraints in terms of budget allocation and matching funds (*peitao zijin*), and political constraints contained in the cadre evaluation system emerge as the most prominent institutional constraints determining local cadres’ behavior and policy outcomes. Consequently, no single pattern adequately describes CNSC implementation in the 21<sup>st</sup> century.

Concerning the fiscal constraints, on the one hand, the revenue-sharing fiscal system has dramatically changed the economic landscape of rural China since the major fiscal reform of 1980 was put in place, metaphorically referred to as “eating at separate stoves” (*fenzao chifan*), a term signifying how members of an extended family would take charge of their own incomes and expenses, i.e. in local government terms it means that each jurisdiction should be responsible for its own fiscal incomes and

expenditures.<sup>6</sup> On the other hand, the inception of decollectivization of agricultural production in terms of household responsibility system (*jiating lianchan chengbao zerenzhhi*) during the reform era robbed village governments of rights to income from the sale of agricultural produce. “Officials in villages without a significant non-agricultural economy were left with empty coffers and little salary for themselves except for whatever fees or surcharges they could extract from their villagers” (Oi, 1995, p.1137). Sequentially, the tax-and-fee reform (*shuifei gaige*) in the early 2000s, aimed at abolishing agricultural taxes, further intensified the constraints that the local governments face. In order to extract sufficient matching funds from local tax revenues, as a consequence rural industry, as the most lucrative source of both budgetary and extra-budgetary revenues, became a prominent source of local public finance.

The cadre evaluation system contained in the *nomenklatura* system<sup>7</sup> has created strong political constraints and incentives for local cadres to maintain and expand their posts and influences with material and immaterial rewards.<sup>8</sup> The evaluation indicators evolve from simple local economy-centered development in the 1980s to a comprehensive social, economic, and environmental development in the 21<sup>st</sup> century, under the heading of building a “harmonious socialist society” (*shehuizhuyi hexie*

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<sup>6</sup> For detailed discussions of fiscal reforms, see Oi (1992); Oksenberg and Tong (1991); Shue (1984), Wong (1991) and Whiting (2001).

<sup>7</sup> According to Christiansen and Rai (1996), “The *nomenklatura* (originally a Latin word, but borrowed through Russian into English; in Chinese referred to as *renshi zhidu*) is the Party personnel administration and control with posts. The Chinese Communist Party has a number of lists of posts within the state and Party hierarchies, the holders of which must be vetted by appropriate Party branches. The top-level appointments and elections roughly down to vice-minister level and vice-provincial-governor level must be sanctioned by the Political Bureau. Lower-level posts must be sanctioned by a Party branch at a higher level of authority” (p.13). The detailed evolution of the cadre evaluation system will be presented in Chapter 3.

<sup>8</sup> The first cadre evaluation system during the reform era was formulated in 1979. See *Zhonggong zhongyang zuzhibu guanyu shixing ganbu kaohe zhidu de yijian* (Opinions Concerning the Implementation of Cadre Evaluation System by the Organization Department of the Central Committee of the CCP). Website of the Communist Party of China. <http://cpc.people.com.cn/GB/64162/71380/71387/71591/4854973.html> (accessed 5 October 2015).

*shehui*).<sup>9</sup> In this sense, local cadres experience far greater pressure imposed by the cadre evaluation system, as they are simultaneously obliged to create job opportunities, promote local economic growth, maintain social stability and improve environmental protection.

### **1.3.2 Institutional Devices: Patterns of Local Governments**

The second and third questions concern the capacity of local governments to respond to the institutional constraints. Indeed, the conjuncture of institutional changes in the tax and personnel systems have engaged local governments in the economic development in order to extract sufficient matching funds from local tax revenues. Different patterns of local governments are created to distinguish the role and the depth of government officials' involvement in the economic activities, resulting in, for instance, the "developmental state" (Blecher, 1991), "entrepreneurial state" (Blecher, 1991; Duckett, 1998), "local corporatist state" (Oi, 1995;1999), "the regulatory state" (Shue, 1995), "the dual developmental state" (Xia, 2000), "the clientelist state" (Pearson, 1997; Wank, 1995), "the market-facilitating state" (Howell, 1993), the "rent-seeking state" (Wedeman, 2003) and "the predatory state" (Bernstein and Lu, 2000). The multiplicity of terms not only reflects the changing nature and relative strength of local governments, but also depicts the strategies of development that local officials adopt and the relations created between local state and business or society.<sup>10</sup> Indeed, local officials' endeavors and strategies to expand the tax base for extracting matching funds have greatly contributed to the rural industrialization since the reform era.

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<sup>9</sup> The concept of "harmonious Socialist society" was first introduced in the resolution of the 16th Party Congress in November 2002 and defined at the fourth plenary session in September 2004 as a society built on "democracy and rule of law, justice and equality, trust and truthfulness, amity and vitality, order and stability, and a harmonious relation with nature." See Holbig (2009, p. 29).

<sup>10</sup> Chapter 2 will present these concepts in more detail.

As this study will show, the economic growth in China was largely credited to the economic institutions created by the state which enabled private enterprises to thrive in China's transition to a rising market economy. This major argument of state-led economic development drawn from empirical data strongly refutes the claims made by Nee and Oppen (2012), that "the rise of capitalist economic institutions rests on bottom-up entrepreneurial action" (p.8) and "the economic success of firms becomes increasingly independent of the direct involvement of politicians" (p.236). Instead, despite the study sharing some similar qualities with the case of the Yangtze delta region presented by Nee and Oppen (2012), whereby they both have analogous historical legacies of handicraft production industry and then develop to a private ownership dominated economy, this study serves as a contrasting case showing how local officials facilitated the economic growth by creating economic institutions for private firms, including credit and financial consulting, market and technical assistance, tax breaks and county support funds, and conflict mediation.<sup>11</sup> These economic institutions play a crucial role in explaining the rise of China's private enterprise economy. However, as the subsequent parts of the dissertation will show, private ownership was not only encouraged by the local government, but also harnessed and used for local accumulation. Private entrepreneurship was, to some extent, bounded by political utility.

Furthermore, it is important to bear in mind that the involvement of local cadres in the economic growth also highlights the economic concept that is rewritten in the official documentation in an ever-changing institutional context. Notably, it changes from "local economy" or "rural economy" since the reform era to the defining "county-wide economy" (*xianyu jingji*)<sup>12</sup> after entering the 21<sup>st</sup> century, signifying the institutional

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<sup>11</sup> Chapter 4 will detail the economic institutions created by the local state.

<sup>12</sup> County-wide economy (*xianyu jingji*) was first put forward in the 16th Party Congress Report dated Nov.8, 2002. It emphasized boosting the county-wide economy in order to make the rural economy flourish and speed up urbanization. See Full Text of Jiang Zemin's Report at 16<sup>th</sup> Party Congress on Nov.8, 2002. Website of Chinadaily. [http://www.chinadaily.com.cn/language\\_tips/news/2013-11/26/content\\_17132209\\_6.htm](http://www.chinadaily.com.cn/language_tips/news/2013-11/26/content_17132209_6.htm) (accessed 5 October 2015). China's 11th Five-Year Guidelines (2006-2010) further clarified the notion of the county-wide economy by focusing on the restructuring and innovation of township-village enterprises (TVEs) and development of central towns. See *Dierpian: jianshe shehui zhuyi xinnongcun* (Chapter Two of Outline of the Eleventh Five-Year Plan (2006-2010):

change in organizational and power structures in localities. In the 1980s and early 1990s, which was characterized by the predominant collective ownership economy, the fiscal and administrative decentralization granted the local cadres great autonomy to exercise their economic powers. County, township and village governments had defined rights to extract profit surplus from collectively-owned firms, thus they established a multi-level corporate-like “local corporatist state” (Oi, 1995, 1999) to manage and run local businesses. Nevertheless, the privatization of collectively owned firms throughout the 1990s fundamentally reshaped the hierarchical structure by stripping the township and village cadres of the rights to extract profit surplus from privately-owned enterprises. As a result, the grip of power aggregates to the county level. The vertical economic structure collapsed; instead, a horizontal economic structure has emerged in the context of the county-wide economy. The change further intensified competition among local governments. Since the concept of “county-wide economy” was written in the political agenda, it has also played a significant role in shaping local officials’ behavior. The county-wide work of economy evaluation and allocating praise was carried out afterwards among provinces.<sup>13</sup> Among them, the evaluation work pioneered by the National Bureau of Statistics in 2004 and 2005 reflects the political and economic significance for counties that were rewarded with a substantial grant. Even though the indexing system and targets evaluation system vary among provinces, the key indicators are identical: GDP and the provision of public goods and social welfare.

### **1.3.3 The Institutional Economic Framework: Property Rights, Transaction Costs and Bargaining Power**

Institutional economics offer a systematic framework for understanding changing

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Constructing a New Socialist Countryside). Website of Chinese government. [http://www.gov.cn/ztl/2006-03/16/content\\_228841\\_3.htm](http://www.gov.cn/ztl/2006-03/16/content_228841_3.htm) (accessed 5 October 2015). In this study, county-wide economy refers to the economic development oriented by non-agricultural economy and based on county and central towns, and the main indicator is the county GDP.

<sup>13</sup> See *Jujiao quanguo ge shengshiqu xianyu kaoping biao Zhang gongzuo* (The Focus of County-Wide Economy Evaluation and Praise Work). Website of China Cities. [http://www.chinacutv.com/Article\\_Show.asp?ViewType=&ArticleID=4811](http://www.chinacutv.com/Article_Show.asp?ViewType=&ArticleID=4811) (accessed 5 October 2015).

institutional arrangements (Levi, 1988; North, 1981). The core concepts of property rights, transaction costs and bargaining power derived from institutional economics are very helpful in explaining the political economy of institutional change in property rights, extractive, redistributive and mediative institutions and how these formal institutions interact with various informal institutions in the process of rural development policy implementation in this study.

Property rights are commonly defined as a bundle of rights that encompass the rights to use, control, derive income from, and alienate an asset. From the institutional economic perspective, secure property rights are extremely essential for economic development (North and Weingast, 1989; North, 1981). The heart of the discussion suggests that the state is closely related to the security of property rights because state officials seek to maximize revenue as much as possible, subject to certain constraints (Levi, 1988; North, 1981; Olson, 1993). As North (1981) notes, “[t]he key to understanding the state involves the potential use of violence to gain control over resources. One cannot develop a useful analysis of the state divorced from property rights” (p.21). However, the ability of the state to maximize the size of economic base from which it can extract revenue is constrained by two factors: costly transaction costs and relative bargaining power (Levi, 1988; Whiting, 2001).

First, the state (principal) is constrained by the transaction costs incurred by “measuring (resource allocation), monitoring (agents and constituents), creating (institutional rules), and enforcing compliance” (Levi, 1988, p.12). Transaction costs involve the contracts between parties who have conflicting interests and for whom measuring and acquiring information is costly. The most important transaction cost in the context of revenue extraction is the cost of measuring the tax base (Whiting, 2001, p.19). For instance, the private enterprises may generate the most revenue in society efficiently, but they may react with a massive tax revolt or tax evasion. Consequently, the state may not be able to extract the revenue if it cannot gather and measure the tax information correctly, and collect it readily.



As far as the matter of principal-agent is concerned, an agency problem arises. The inevitable information asymmetries and conflicts of interests shape the principal-agent relationship by creating adverse selection, moral hazard and incentive problems (Moe, 1984).<sup>14</sup> The monitoring mechanism is always used by the principal to oversee and regulate the agent's behavior. However, the process is costly and less effective if the agent colludes with partners to deceive the principal. The capacity of the central state in the context of extracting revenue is undermined by the dual role of local cadres and multiple-principal arrangements. For example, the tax collectors at the township level are both principals and agents in the revenue extractive system, which incentivize them to divert more revenues from collective firms to their local coffers (Whiting, 2001). Whereas the multiple-principal arrangements motivate local tax, finance and audit bureau officials to prioritize their immediate principal's interests rather than those of the central state (Oi, 1999).

Second, the state is subject to constraints imposed by its relative bargaining power vis-à-vis its key constituents. The bargaining power is determined by the extent to which one party controls resources on which the other party depends (Whiting, 2001, p.20). The concept of bargaining power is a relative term. As Levi (1988) points out, "[r]ulers will have more bargaining power the more they monopolize coercive, economic, and political resources. Rulers will seek to control the supply of resources or by eliminating rival suppliers. [...] When others possess resources that the ruler needs or when they can successfully resist the ruler's demands, their bargaining power is increased" (p.12). In the context of revenue extraction, the business sector provides proportionally more of a share of a needed tax resource, and holds more bargaining power than the state.

#### **1.3.4 Institutional Change in Rural Social Policy Implementation**

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<sup>14</sup> Chapter 2 and Chapter 4 will respectively examine principal-agent relationship theoretically and empirically.

The approach to institutional change developed here begins by examining how the incentives and constraints contained in the institutional frameworks in place at the beginning of the reform era led to the emergence and evolution of private dominated property rights. The evolving model of property rights has implications for the evolution of local institutions for extracting matching funds, redistribution and conflict mediation in the process of rural social policy implementation.

Extending the developmental state model to the local level, the central task of this study is to analyze the dynamic implementation of the critical rural development project in Fugu County and subordinate towns, which is characterized by its substantial coal resource endowment and privately owned enterprises. Aggregate statistics show that the private sector has contributed to the lion's share of the county-wide economy since the end of the 1990s, a crucial period in which collectively owned enterprises were transformed to private ownership. In 2006, the Fugu County government immediately carried out CNSC implementation in response to the central state's call, adopting the experimentation-based approach to financing and establishing ten model villages. However, constrained by the shortage of matching funds, the local state was unable to extend the model villages to a large extent, and expand their political and socioeconomic influences, which would affect local officials' performance evaluation conducted by the upper authorities. As suggested by the institutional economic model, the shortage of matching funds has become the primary causal factor that most often determined the influence of transaction costs on the implementation of CNSC because the local state was faced with constraints in mobilizing and raising matching funds from outside public finance, which might extend the period of time for project implementation and increase the risk of implementation failure. In addition, the constellation of property rights determined to a large extent the level of information and transaction costs and the distribution of bargaining powers confronting local officials in Fugu County, which was initially a predominantly private ownership locality. In this sense, political and economic power was quite distinct as the private sector held more bargaining power than the local state. As a result, local officials faced high information and transaction costs governing

private firms and implementing CNSC. At the same time, the bargaining power of private capital constrained the ways in which local officials promoted the county-wide economy, retained private capital flow, and innovated in the design of extractive, redistributive and mediative intuitions to cope with high information and transaction costs.

“Rulers must devise policies that lower their transaction costs. These are the costs of implementing and enforcing policies” (Levi, 1988, P.12). To mitigate the risk and reduce the transaction costs of CNSC implementation, the local state takes a shortcut, targeting the lucrative private sector as the source of extracting matching funds. Property rights evolve in response to the constraints of and incentives for local cadres to expand local tax base. In 2007, to retain private capital flow within its jurisdiction and harness the coal resources for their own political and economic purposes, the local state used some managerial strategies - Local State Entrepreneurial-Developmentalism - to change the ownership structure from private dominated to mixed ownership by regaining state ownership of the private enterprises gradually, under the national coal mine restructuring framework. The institutional change in the form of property rights reflects the apparent path dependence in the implementation of CNSC. Moreover, in contrast to Nee and Oppen (2012) who argue that private entrepreneurs acted in an institutional environment characterized by weak property rights, this study will show that the private property rights remained relatively stable in the process of institutional change in the ownership structure. Even though the local officials controlled the private firms through creating beneficial conditions and enterprises of mixed ownership, the purpose was to attract and retain the private capital within its jurisdiction. To some degree, private entrepreneurs still held the secure and clearly defined rights to their assets and mobile private capital that allowed them to invest anywhere they wished to because the local government could not constrain the capital flow.

Concurrently, the county and township cadres formed a “Strategic Group” (Evers, 1966, 1973; Heberer and Schubert, 2012) to co-opt private entrepreneurs into the

“Double Hundred” project (*shuangbai gongcheng*) devised by the local state on purpose, which was consistent with the central framework of CNSC. Surprisingly, as this study will show, in addition to changing the ownership structure to extract the matching funds from tax revenues, the local state has used CSR<sup>15</sup> as the second approach to raising matching funds and implementing the “Double Hundred” project. CSR is conventionally initiated by enterprises to “integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis” (European Commission, 2001; 2002; 2006, as cited in Steurer 2010, p.50). Nevertheless, departing from the conventional wisdom that CSR is deemed as an enterprise-oriented neoliberal and voluntary concept, helping to downsize state regulations, this study shows that the local officials in Fugu County used CSR to justify their behavioral pattern of redistributing resources through direct compensatory fiscal transfer from the private sector to affected farmers and charity giving to the county as a whole, and town cadres raising the matching funds from the private firms/mines through pairing schemes (*jiedui bangfu jizhi*) that paired private firms with aided villages.

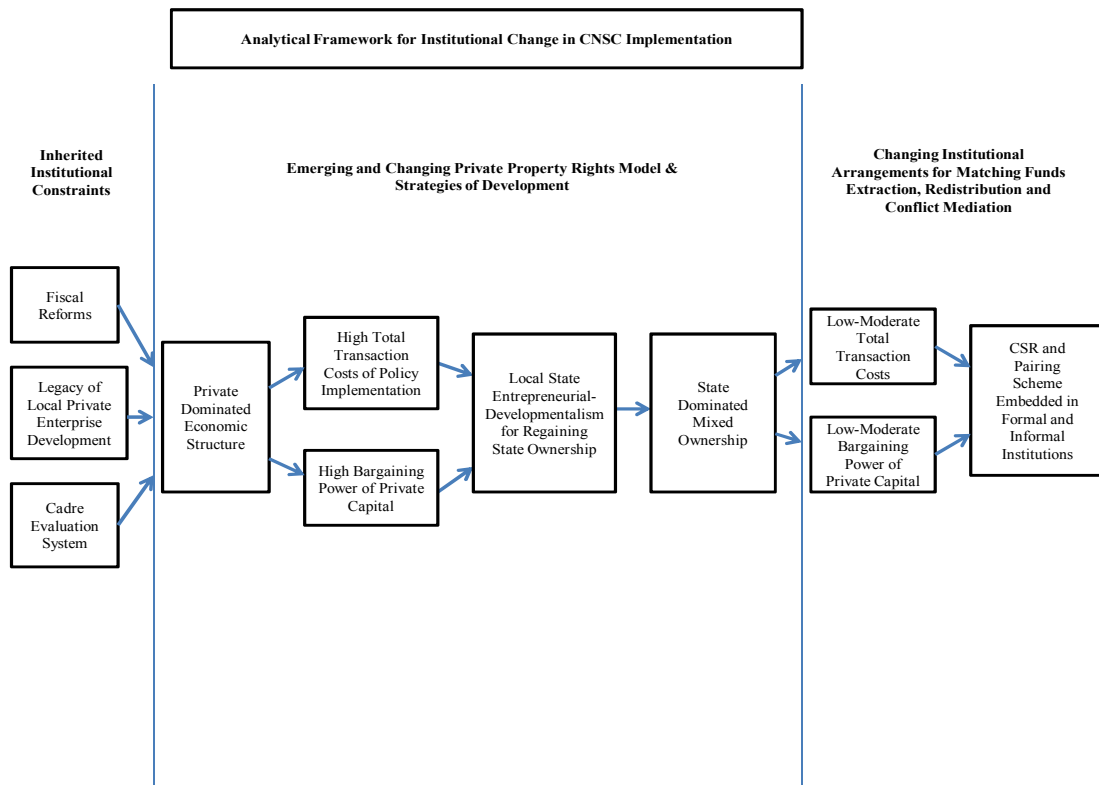
In a nutshell, the process of institutional change at the local level is summarized in the analytical framework of CNSC implementation (see Figure 1.1), which will guide this study. The incentive contained in the fiscal reforms and the cadre evaluation system, interacting with the legacy of local private enterprise development, determines the private dominated economic structure. The substantial proportion of private firms contributing to the local economy gives rise to the high total information and transaction costs of governing the private firms and policy implementation and the high bargaining power of private capital. These two factors affect local officials’

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<sup>15</sup> The Chinese Government defines CSR as follows: “Corporations should carry out their social responsibilities by abiding by all relevant laws, regulations, and business ethics codes. While pursuing economic profits, corporations are held responsible by shareholders, employees, consumers, suppliers, communities, and other stakeholders. Moreover, corporations have responsibilities to protect the environment” (Foundation for Environmental Security & Sustainability, 2008). The notion of CSR comprises three pillars under the triple bottom line framework, namely, the economic, the social and environmental responsibilities (Fox et al., 2002; Elkington, 1998). This neoliberal ideology is in sharp contrast with the neoclassical shareholder view of CSR that asserts that a firm’s only responsibility is to do business and make a profit (Friedman, 1970; Henderson, 2001 a;b).

strategy of development, namely adopting a local state entrepreneurial-developmental mechanism to regain the state ownership of private enterprises. As a consequence, the local state's managerial strategies turn the private dominated economic structure into state dominated mixed ownership which has reduced the total information and transaction costs and the bargaining power of private capital. These two factors, in turn, further shape the nature of institutional arrangements for extracting matching funds, redistribution and conflict mediation. The process of institutional change reflects two research propositions: **(1) local officials regained state ownership of private firms because they must lower the transaction and information costs and reduce the bargaining power of private capital; and (2) the formal and informal institutions interacted closely in the process of CNSC implementation, for example, in the formation of strategic group and in the process of extracting matching funds, redistribution (i.e. CSR) and conflict mediation through pairing schemes.** The two research propositions at the core of this study focus on the apparently path-dependent development of property rights, extractive, redistributive and conflict mediative institutions used throughout the implementation of CNSC.

**Figure 1.1: Explaining Institutional Change in CNSC Implementation at Local Level**



Source: Own compilation

## 1.4 Research Design and Methodology

The study was conducted as a comparative case study based on a qualitative inquiry strategy using in-depth interviews, field observations and extensive archival research. The objective of the study is to identify and explain the model of local government and the patterns that emerged in the evolution of property rights and extractive, redistributive and mediative institutions. Fugu County was selected to represent the concentration of private ownership form, and two subordinate towns were selected for variation in the resource endowment. The small sample of one county with subordinate towns in northwestern China is not intended to be representative of rural China as a whole. Instead, the study is intended to explain the institutional change in property rights and extractive, redistributive and conflict mediative mechanisms of social policy implementation, and show how these mechanisms interact with various informal institutions in the context of rural China. The empirical findings derived from

systematic analyses might be generalized to a larger context of similar institutional settings and served as benchmarks against which to compare the findings of other regions.

The fieldwork was carried out in Fugu County and its subordinate towns. The nine-month fieldwork period was divided into two time slots, from September 2012 to February 2013 and from September 2013 to November 2013. The selection of subordinate units was nested: two towns with a distinct coal resource endowment, one or two large private companies within selected towns, and administrative villages pairing with private companies. Qualitative data is comprised of 32 semi-structured interviews with three groups (local officials at county, town and village levels, local coal mine/enterprise managers, villagers in Fugu County) and government documents, internal reports, local history book (*xianzhi*) collected through substantial fieldwork. Additional interviews were conducted with officials and scholars based in Beijing. These open-ended interviews generally lasted for two hours. In conducting interviews, I encouraged the informants to answer questions freely, allowing interview subjects to offer as much information as possible, but attempted to cover the same content in each interview based on a standard interview outline for each of the three categorized groups. The standard interview outline of local officials at county, town and village levels included questions on the informant's personal background, the motivations for and constraints of implementing CNSC, the strategy of development, the patterns and mechanisms of poverty alleviation practice and their understandings of CSR. At the enterprise level, the interview format included questions about a manager's personal background, the company's business operation information, their response to and interaction with local government's pairing schemes, the patterns of poverty alleviation, conflicts management and their understandings of CSR. At the villager level, the interview format included questions about the patterns of poverty alleviation in the village, the changes in the village after program implementation and conflict issues.

To address the concern of the reliability of interview data, I employed three strategies.

First, some questions across the three groups designed in the interview format are overlapped so that it is possible to cross-validate each informant's statement. Second, I did a large review of secondary documentation to increase the accuracy of my interview data. Many of these government documents are only for internal use, not publicly accessible, including meeting minutes, government reports, "red-character-titled documents" (*hongtou wenjian*), and land circulation and conflict mediation contracts. Third, field observation also facilitates the validity of my interview data by closely observing the actual interaction and engagement behavior of actors, including observations of a mobilization meeting of county and town cadres convened by the county Party secretary and a few company meetings that involved local cadres in them.

In addition, to protect the informants from any latent harm resulting from the data they provided, I discarded the real names of my interview partners and companies. Instead, I developed a code system to refer to the interviews and to the companies and the government agencies, and used pseudonyms to protect the anonymity and confidentiality of my interview partners (see Appendix III).

### **1.5 The Region of Fugu County in Flux**

Fugu County is a particular representative of the concentration of private ownership structure stemming from its distinctive resource endowment and historical legacies. It is located in the north of Shaanxi Province, where to the north it borders the Inner Mongolia Autonomous Region and the east Shanxi Province. Both neighboring regions are also filled with substantial coal resources. The region of Fugu County is situated in the interior of the Shenfu-Dongsheng coalfield that is China's largest coal-producing base, accounting for 25% of the country's total coal reserves.<sup>16</sup> There are 20 billion tons of proven coal reserves in Fugu County.<sup>17</sup> As described by the Local

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<sup>16</sup> See China's Largest Coalfield Curbs Ecological Deterioration. Website of People's Daily. [http://english.peopledaily.com.cn/200107/06/eng20010706\\_74339.html](http://english.peopledaily.com.cn/200107/06/eng20010706_74339.html).

<sup>17</sup> See *Jiben gaikuang* (An Overview of Fugu County). Website of Fugu County Government.



History of Fugu County (*Fugu xianzhi*, p.319-320), during the period of Republican China, the handicraft industry had developed to a certain scale involving 1,000 practitioners in cottage industries (*jiating zuofang*) run by local farmers, who combined production with sales. By the mid-1950s, before the Socialist Transformation of Industry and Commerce campaign,<sup>18</sup> such small enterprises had rapidly developed from 97 households with 979 practitioners in 1950 to 180 households with 1,236 practitioners in 1953. However, the Socialist Transformation of Industry and Commerce campaign in the mid-1950s transferred the ownership of the means of production into public ownership, “either as ‘ownership by the whole people’, that is ownership where the organs of the state manage the ownership on behalf of all citizens, or ‘ownership by the laboring masses’, that is where the workers own their means of production as a collective. Both forms were actually instituted in the mid-1950s and became the only legal forms of ownership” (Christiansen and Rai, 1996, p.76). Against this background, Fugu’s private handicraft firms and coal mines did not remain part of the rural economies until they reemerged after 1978. Fugu’s private industrialization took off in the mid-1980s. In 1984, following the far-reaching *1983 Document One*<sup>19</sup> issued by the Central Committee, Fugu County’s government formulated a series of local rules to facilitate the development of “township and village enterprises” (TVEs, formerly “commune and brigade enterprises”-*shedui qiye*)<sup>20</sup> run by townships, villages, individuals or in joint forms. These four different types of enterprises in the political jargon of the time epitomized development

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[http://www.fg.gov.cn/Category\\_233/Index.aspx](http://www.fg.gov.cn/Category_233/Index.aspx) (accessed 5 October 2015).

<sup>18</sup> For a detailed discussion of the Socialist Transformation of Industry and Commerce campaign, see Lieberthal (1995, pp.86-96) and Christiansen and Rai (1996, pp.75-76).

<sup>19</sup> For the political and economic significances of *1983 Document One*, see Christiansen (1989) and Christiansen and Rai (1996).

<sup>20</sup> According to Christiansen and Zhang (1998), township and village enterprises (TVEs) are umbrella terms that refer to any non-agricultural enterprises located in rural areas. They include both enterprises owned collectively by the townships, the towns or the administrative villages and those owned privately by farmers, by partnerships and by shareholders. Also see the definition provided by the Ministry of Agriculture (1985).

“moving ahead on four wheels” (*silun qudong*).<sup>21</sup> 1989 became the tipping point of growth, as Fugu’s private sector for the first time exceeded the value of publicly owned enterprises. The total industrial output value reached RMB 91.682 million, of which private sector contributed with 54.57 million, accounting for 60% of the total output value and 1.5 times that of the publicly owned enterprises (*Fugu xianzhi*, p.321). Since then, coal-endowed private enterprises began to dominate the local economic structure and produced revenues very efficiently.

Along with its success in rural industry, Fugu County earned substantial political and economic capital, ranking among the provincial top 10 counties and the national top 100 counties respectively in terms of GDP and fiscal revenues for many years. In 2005, the county GDP reached RMB 2.25 billion, 2.6 times more than in 2002. It ranked 35<sup>th</sup> out of 83 counties in Shaanxi Province County Economy Comprehensive Assessment. By 2007, its GDP had reached RMB 4.67 billion, ranking 5<sup>th</sup>. Although Fugu County was in the grip of a long term economic crisis in 2008, the county GDP rocketed to RMB 11.64 billion, ranking 3<sup>rd</sup>.<sup>22</sup> Notably, Fugu County has entered the ranks of “China’s top 100 counties” (*zhongguo baiqiangxian*) four times since 2010.<sup>23</sup> Indeed, the coal-led private industry based on the huge coal endowment has apparently played an extremely important role in boosting the county-wide economy. By 2011, there were 1,016 corporations in total, in which 301 were industrial corporations. 88 coal companies and 99 coal-related companies accounted for 62% of total industrial corporations.<sup>24</sup> In 2011, the private county economy reached RMB 47.4 billion, or 66.5% of the county GDP. Furthermore, its contribution to the county tax revenues

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<sup>21</sup> This was a pun on the development strategy of the 1950s “walking on two legs”, i.e. relying on both agriculture and rural industry for development. Chapter 4 examines the process of the privatization of rural industrial enterprises.

<sup>22</sup> See Lu et al. (2010).

<sup>23</sup> The evaluation and ranking of the “China’s top 100 counties” was formerly conducted by the State Statistical Bureau in 2004 and 2005 and a non-governmental research institute afterwards. For a more detailed analysis of China’s county-wide economy, see Ling (2003), Li and Zhu (2005).

<sup>24</sup> See *Minying jingji gaikuang* (An Overview of Private Enterprise Economy). Website of Fugu County Government. <http://www.fg.gov.cn/Item/6394.aspx> (accessed 5 October 2015).

reached 69.3%.<sup>25</sup> To put it differently, the coal-led private economy contributed more than two thirds of the county-wide economy.

Nevertheless, since the turn of the new century, Fugu region underwent a profound socioeconomic transformation induced by coal mining, leading to the paradox of rich-land-poor-community. A very recent census in 2010 showed that the population of Fugu County was 260,585, in which, the rural population was 111,711, or 43% of total population (National Bureau of Statistics, 2010).<sup>26</sup> In fact, the rural polarization of wealth has been exacerbated by the coal-endowed economy. On the one hand, the magic “black gold” has not only generated substantial tax revenues from its robust county-wide economy, but also created a large number of billionaire coal mine owners, popularly called “coal bosses” (*meilaoban*)<sup>27</sup> or “farmers-turned-entrepreneurs” (*nongmin qiyejia*)<sup>28</sup> due to their indigenous, uneducated, and in some cases even completely illiterate background. Yet they were wise and audacious enough to seize the opportunities when the local state contracted coal mines to individuals in the 1980s. On the other hand, the local farmers in the poverty-stricken areas have suffered from direct and destructive structural damage to local livelihood, infrastructure and local biodiversity, inducing soil erosion, groundwater contamination and dust. As a result, the inequality and the form of rural polarization have triggered intensive distributive conflicts between the billionaires and the affected farmers. Furthermore, despite the fact that coal wealth has created a large number of billionaires, the low per capita annual income has affected the socioeconomic status as a whole. Fugu County has been on the list of national poor counties of China since 1994, the epithet of “poor

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<sup>25</sup> See *Minying jingji* (An Overview of Private Enterprise Economy). Website of Fugu County Government. <http://www.fg.gov.cn/Item/6394.aspx> (accessed 5 October 2015).

<sup>26</sup> See Tabulation on The 2010 Population Census of The People’s Republic of China by County, Beijing: China Statistics Press

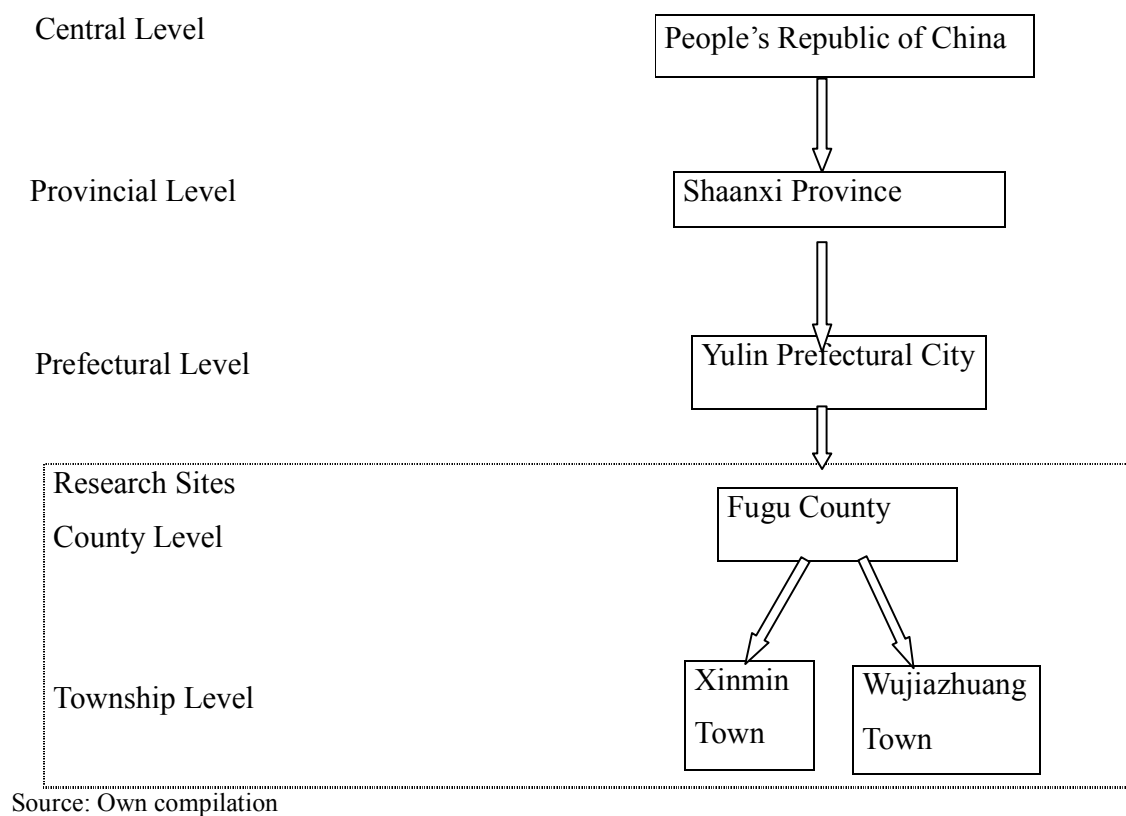
<sup>27</sup> *Meilaoban* is commonly quoted in most mainstream news reports, and literally refers to a coal boss or coal mine owner. I select coal mine owner in the study in a less aggressive and negative way.

<sup>28</sup> It refers to the entrepreneur who was born in a farmer family and worked as a farmer before becoming an entrepreneur.

county” was removed only until 2012 (measured by the annual income per capita).<sup>29</sup>

The location of research sites in the administrative hierarchy is shown in Figure 1.2, and its geographic location is shown in Maps 1.1 and 1.2.

**Figure 1.2: Administrative Hierarchy in the Research Sites.**



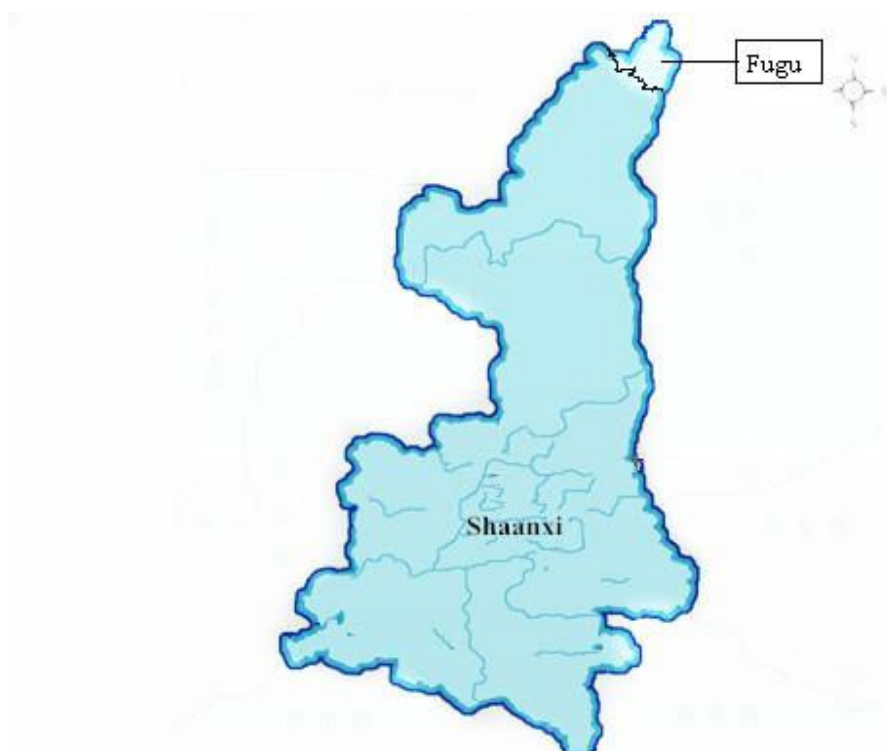
**Map 1.1: Map of China Showing Shaanxi Province**

<sup>29</sup> The key measuring indicator of national poorest counties is the per capita annual income. In 2012, the criterion was RMB 2300. See *2012 nian guojia fupin kaifa gongzuo zhongdianxian mingdan quanguo gong 592 ge* (List of 592 National Poverty Reduction and Development Counties in 2012). Website of China. [http://www.china.com.cn/policy/txt/2012-03/19/content\\_24930336.htm](http://www.china.com.cn/policy/txt/2012-03/19/content_24930336.htm) (accessed 5 October 2015).



Source: Own compilation

**Map 1.2: Map of Fugu County in Shaanxi Province.**



Source: Own compilation

## **1.6 Structure of the Dissertation**

The argument is presented in seven chapters. Chapter 2 provides the theoretical underpinning of this study. The first section introduces the concepts of developmentalism and the developmental state, and the role of the state in the socioeconomic development among countries and regions. The second section elucidates the various relationships between state and society, and between state and business. The third section considers the four universal implications of the developmental state. The fourth section discusses the experiences and lessons that China has learnt and applied to its policy making and what the universal implications in China have been. It further focuses on the center of the theoretical framework by delineating the patterns of developmental state at the micro level, and theorizing the “Local State Entrepreneurial-Developmentalism” in the analysis of the “county-wide economy”. Specially, it presents the local state and business relations and the agency problem of central-local relations. The last section explores the strategic group approach and its application to the analytical approach.

Chapters 3 to 6 focus on the empirical analyses and findings of this study. Chapter 3 considers the fiscal reform and cadre evaluation system as institutional incentives. The first section examines how CNSC implementation is constrained by the institutional arrangements (i.e. matching funds and cadre evaluation pressure). The second section elucidates how the institutional evolution contained in the fiscal reforms and cadre evaluation system from the late 1970s till the 2000s shaped local officials’ behavior. It argues that the revenue-sharing fiscal system and the cadre evaluation system have created powerful economic and political incentives for local cadres in Fugu County to promote rural industry which is served as the source of local public finance and the premise of matching funds of CNSC implementation.

Chapter 4 centers on the rise of Local State Entrepreneurial-Developmentalism in Fugu County. The first section starts with a discussion of rural industrial evolution, which is seen as the strategies of local development. The following subsections review

the evolution of rural private sector from 1979 to 2003. Taking a case study of coal mine restructuring practice, the second section examines why local officials in Fugu County are incentivized to regain the state ownership of private enterprises and how they achieve this. The subsections delineate the specific administrative and economic control mechanisms in association with inducements in order to promote the county-wide economy. The third and fourth sections discuss the consequences of the Local State Entrepreneurial-Developmentalism, respectively elaborating the state-business symbiotic relationship and principal-agent relationship.

Chapter 5 focuses on the dynamic interactions between formal and informal institutions in the formation of strategic group and implementation of CNSC. The first section identifies the differences and features of three institutional structures: the Party, the state and the strategic group. The second section shows how strategic group is established by the leading county and town cadres in Fugu County. It further examines the strategic agency in the implementation of “Double Hundred” project in line with CNSC. In particular, the local coal mine owners/entrepreneurs are incorporated in the strategic group in order to effectively carry out the project. It also explains how the internal evaluation system functions as a strategic agency and shows how CSR is used as a redistribution mechanism in the project implementation.

Chapter 6 focuses on the “Double Hundred” project implementation at town levels. It starts with the case of Xinmin Town and follows the case of Wujiazhuang Town, showing how the town cadres create institutional arrangements for extracting matching funds, redistributing resources and mediating conflicts. Both case studies demonstrate that the informal institutions (i.e. local customs, *guanxi*, prestige, skills, knowledge, affinity and *mianzi*) closely interact with the formal extractive, redistributive and mediative institutions. However, the case of Xinmin Town demonstrates that coal mines and corporations are voluntarily compelled to pair with local villages in the business operation areas as they are in face with the social and economic pressures exerted by the farmers. Town cadres have innovated a package of mediative institutions to coordinate the interests in order to resolve the conflicts

between the mines/corporations and farmers. The case of Wujiazhuang Town shows how one coal mine owner had already voluntarily carried out rural development practice in his home village prior to initiating CNSC. Thus local cadres in this town were faced with less tremendous pressure than the other.

Chapter 7, in conclusion, reviews the core research findings and the research contributions, as well as reflections on and implications for future research.



## **Chapter 2. Developmental State and Local State Entrepreneurial-Developmentalism**

### **2.1 Preamble**

This chapter focuses on the theoretical exploration of developmental state<sup>30</sup> and the analytical strategic group approach. It first reviews the concepts of developmentalism and developmental state, and the role of the state in the socioeconomic development among countries and regions. Second, it examines the various relations between state and society, and between state and business. Third, it discusses the four characterizing features of the developmental state. Fourth, it elucidates the experiences and lessons that China has learnt and adapted to its policy making and how the universal implications of these have applied in China's context. Furthermore, the section introduces the core of the study by identifying the patterns of developmental state at micro level, and conceptualizing the "Local State Entrepreneurial-Developmentalism" in the analysis of the "county-wide economy". Specially, it presents the local state and business relations and the agency problem of central-local relations. The last section explores the strategic group approach and its application to the analytical approach.

### **2.2 State and Developmentalism**

In the context of institutional arrangements in terms of powerful policy instruments and functional state structure, I follow Meyns and Musamba (2010, P.23-24), and argue that the bureaucracy goes well beyond the Anglo-Saxon model, and takes a form that enables the state to effectively harness markets.

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<sup>30</sup> The developmental state has been widely studied. Among them, Bolesta (2012) conducts a comprehensive literature review of the concepts, political and economic conditionalities of developmental state.

Over the last three decades of economic reform and liberalization of markets, China's rapid economic development at the dramatic rate of no less than 10% per annum has evinced that government intervention is one of the most salient determinates (Howell, 2006; Knight, 2014; Oi, 1999; Whiting, 2001). What does fast economic growth amount to with regard to the role of the state? Which government interventions and which underlying political economy have led to the successful economic development? A host of scholarly works on China's developmental trajectory and institutional reforms has suggested that China is a developmental state (Baek, 2005; Beeson, 2009; Bolesta, 2012; Knight, 2014; Nee et al, 2007; Oi, 1999; Whiting, 2001). This study not only contributes to the argument of China as a developmental state, but on top of that reinforces the argument by casting the local state in the lead role of the socioeconomic development process.

### **2.2.1 Defining Developmentalism**

What is developmentalism exactly? According to Hill and Fujita, "[d]evelopmentalism is a body of political economic thought that advocates state-managed markets in the national interest" (Hill and Fujita, 2012, p.258). The concept emerged in the needs of late-industrializing nations attempting to catch up with advanced Western capitalist economies that were led by a neoliberalism "which advocates organizing society on the model of an idealized free market economy" (Hill and Fujita, 2012, p.258) since the late 1970s. The developmentalist notion explicitly rejects the tenets of classical economic liberalism that consists of self-regulating markets and individualism. On top of that, developmentalists also reject the neoliberal notion that government should not intervene in the economy. By rejecting the classical and neoliberal notions, developmentalists call for not only the state to take a lead in promoting economic development, international competition and industry expansion but also cooperation among government, business and labor under state leadership to speed up technology upgrades and reduce production costs (Hatch and Yamamura, 1996). Public ownership,

planning mechanism and growth-oriented objective setting are institutional means for achieving national economic growth.

In contrast to the neoliberal economic policy in terms of free trade, financial deregulation, and privatization of state enterprises, developmentalists recommend selective approaches of state intervention to protect domestic markets from international economic competition, control over the capital market, and launching forceful industrial policies to improve manufacturing performance and boost exports (Hill and Fujita, 2012). Industrialization is seen by the developmentalists as the highest priority, and industrial policies are the state's primary vehicles for achieving economic objectives. As Hill et al. (2012, p.6) put it,

“[t]he government uses industrial policies and its powers over capital allocation to protect domestic industries, develop strategic industries, and adjust the economic structure to changes in the world economy. The state attempts to combine industrial policies with competition among private firms through the use of market-conforming methods of economic intervention. Bureaucrats have sufficient talent and autonomy to take initiative, make effective decisions, and deter the claims of interest groups that would undermine economic growth.”

### **2.2.2 Defining the Developmental State**

Developmentalism is an economic form of catching up, and the developmental state is the prime mechanism for catching up. Originally, the concept of the developmental state was put forward in the early 1980s by Johnson (1982) and refined by Amsden (1989) and Wade (1990), who explained the rapid economic growth of the Four Little Tigers (Singapore, Hong Kong, Taiwan and South Korea).<sup>31</sup> It refers to the phenomenon of state-led economic development “in the context of the economic policies that were adopted in East Asia to generate rapid industrialization, and sometimes it is tied to a particular industrialization strategy” (Knight, 2014). The rival

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<sup>31</sup> See Johnson (1982) in reference to Japan, Amsden (1989) in reference to South Korea and Wade (1990a) in reference to Taiwan and comparison. A detailed elaboration of their work will follow.

explanation of developmental state for the successful socioeconomic development of East Asian newly industrializing countries (NICs) has challenged the dominant neoliberal account that the market is the prime vehicle for the “economic miracles” and the role of a minimalist state in the economy.

The studies of the developmental state in the literature have been extensively conducted from various dimensions, such as ideological background, indicators, political, economic and social characteristics and institutional arrangements. For instance, Knight (2014) divides the classification of the developmental state into two criteria: one is that the country’s government gives the highest state policy priority to economic development; the other is that the government adopts institutional arrangements and incentive structures that will lead to unprecedented developmental achievements. Stubbs (2009) distinguishes three key ingredients of the developmental state: first, that is “essentially institutional [...] a cohesive set of institutions with a relatively autonomous capacity to implement a planned strategy for capitalist economic growth.” Second, relational aspects that emphasize the interaction among the developmental state actors in political, economic and social dimensions as a “seamless web of influences” (Stubbs, 2009 as cited in Bolesta, 2012, p.21). Third, “the ideational aspects of the developmental state with particular attention being paid to nationalism, (neo)mercantilism, economic transformation, rapid industrialization, performance legitimacy or some amalgam of a number of these ideas” (Stubbs, 2009, p.6). Howell (2006, p.275) concludes that “the ideal-typical developmental state has the following key features: first, it has a political and policy elite committed to economic growth and transformation, with the power, authority and legitimacy to promote a developmental agenda. Often motivated by strong nationalist sentiments, such elites strive to modernize their countries, raise economic living standards and bridge the developmental gap. Second, complementing such a development-focused elite is a competent, authoritative state administration, particularly in the economic sphere, with the technical and managerial capacity to guide and steer economic and social development.”

### **2.2.3 The Role of State Interventionism**

As far as the role of an interventionist state in promoting economic growth is concerned, one first needs to understand what the definition of an interventionist state is, what the relationship between the developmental state and interventionism is and why the developmental state interventionism is different from the traditional interventionism present in continental Western Europe. According to Bolesta (2012, p. 52), “[t]he interventionist state is understood as one which is characterized by the Keynesian economic model, where the arbitrary and inequitable distribution of wealth and income is being corrected by the government, to the extent that it is widely perceived to be interventionist. It is believed that the degree of interventionism can be measured by the size of governmental ownership, specific economic regulations and level of taxes”. The developmental state is closely connected to interventionism because the former is required to wield the interventionist power of the state to guide the process of the industrialization of national economies. In this sense, the developmental state is seen as a strong interventionist state that devises and reinforces the developmental strategies and trajectory, as opposed to a weak state. However, the effect and performance of developmental state interventionism is questioned by the experts of World Bank (1993, p.6), “[i]t is difficult to test whether interventions increased growth rates. [...] We know that intervention did not significantly inhibit growth”. This report points out that the intervention of historical developmental states was “mild” and “careful” and free market mechanism would play a more effective and distributive role (World Bank 1993).

In general, developmental state interventionism refers to the state’s crafted interventions in the economy with regard to guiding the development process through a set of plans, regulations, policies and additional incentives. What are the distinctive features between the developmental state interventionism and the contemporary Western European interventionism? First, the objectives of interventionism in two contexts are different. The primary goal of a developmental interventionist state is to build institutional arrangements to promote socioeconomic growth and development

and in the end, catch up with developed countries. The classical Western European interventionist state aims to protect and promote social well-being and the cohesion of its citizens. In this sense, the overall development goal is regarded as secondary (Bolesta, 2012, p. 55).

Second, a traditional Western European interventionist state lacks economic bureaucracy as the pilot agency governmental structure, which is in charge of guiding and coordinating the economy by formulating growth-oriented objectives and institutions. In the East Asian developmental states, examples of the role assumed respectively by their economic agency include the Ministry of International Trade and Industry (MITI) in Japan, the Economic Planning Boards (EPBs) in South Korea and Singapore and the Council on Economic Planning and Development in Taiwan. As Waldner (1999, p. 41) observes, the central guidance agency is an imperative for the national economy, “because state-led industrial restructuring displaces market signals through mechanisms such as subsidies, the socialization of risk, and administered pricing”. These mechanisms are all features of a developmental interventionist state.

Third, the degree of interventionism present in both interventionist states underlines that the “developmental state interventionism is not about the strict regulation of economic processes, but rather about governmental leadership over the facilitation of the development trajectory. This trajectory can only be achieved once the business sector enjoys an adequate free market environment in which to perform” (Bolesta, 2012, p. 56).

Finally, according to Bolesta (2012), the embodiment of a developmental state as opposed to classical Western European interventionism shows mainly in the state-business alliance, where the state involves in the private sector in a less (South Korea) and more (Japan) subtle way, by granting incentives for achieving certain projects related to the overall developmental strategy.

#### **2.2.4 Country and Region Specific Examinations**

The extensive scholarly enquiry of the concept of the developmental state and the role of the state in the economic development is country or region specific, considering their regional variation. For example, as for the applicability of the concept of the developmental state, Woo-Cumings et al. (1999) examine European countries including Austria, Finland, France and Germany, as well as Scandinavian countries, that are sometimes depicted as representing certain types of developmental states. Schneider (1999) portrays the states of Mexico and Brazil in Latin America as examples of developmental states. In Africa, Botswana is presented as the African example of the developmental state pattern (Bolesta, 2012). In Asia, a large number of countries have been examined in the context of the developmental state. Apart from the Four Little Tigers, China, Malaysia, Thailand, Indonesia, Vietnam and the Philippines, the so-called late developers compared to the established Western powers, have also been analyzed. Among them, for example, Park and Lepawsky (2012) examine the similarities and differences in the political-economic and spatial restructuring process in South Korea and Malaysia, while Hill and Fujita (2012) conduct an analysis of developmental policy in Thailand.

As for the role of the state and the institutional arrangements in economic growth, Chalmers Johnson's research on Japan demonstrates the high correlation between institutional arrangements and economic successes. His work attributes the average high growth rate of GDP (8% per annum) from 1952 to 1980 to the pivotal role of the state (Johnson, 1982). Following him, Amsden (1989) and Wade (1990) highlight the respective strategic role of the governments of South Korea and Taiwan in guiding the processes of industrialization and modernization that led in the former to economic growth of 9% per annum over the period 1965-90, and in the latter also by 9% per annum from 1960 to 1990 (Knight, 2014). Focusing on their respective developmental strategies, Haggard (1990) examines the examples of Mexico and Brazil with regard to society-rated conditions, including the legacy of rural society, the position of labor force and the benefit of capital. He suggests that developmental strategies were very

much an element of the Latin American developmental model, despite their regional variations. For example, the development of Mexico and Brazil was characterized by import-substitution industrialization, which ultimately resulted in the expansion of manufactured exports, however, not as deeply as was observed in East Asia (Bolesta, 2012).

Similarities and differences with developmental projects have been examined between various developmental regions and countries. For instance, Schneider (1999) conducts a comparative study between East Asia and Latin America and discovers the similarities: “Developmentalists in East Asia and Latin America are nationalists, believing in prime importance of national industrialization and in the state’s responsibility to promote it. Developmental state in both regions take a plan-rational approach to the economy, pursuing a form of political capitalism in which profits and investment depend upon decisions made in the state but in which property and wealth are mostly left in private hands. Developmental political projects in both regions also have a history of authoritarianism, being led by single-party regimes dominated by the military or by a centralized political executive” (Schneider 1999 as cited in Hill et al. 2012, p.13). Meanwhile, “the sharpest contrast between Latin American and East Asian developmental states resides in the bureaucracy: Latin American bureaucrats do not have the embedded autonomy characterizing East Asian officialdom (Evans 1995, as cited in Hill et al. 2012, p.13). Unlike East Asian developmental states, “Latin American bureaucracies are bloated, weakly institutionalized, and unstable. State officials receive less training and lower salaries. Bureaucratic power is distributed through patronage rather than by merit and is more prone to corruption. Dependent upon political machines or the military, and subject to immediate dismissal, bureaucrats in Latin American states are less insulated from private interests than in East Asia, where a credentialed civil service helped create a professional and nationally committed phalanx of officials” (Schneider 1999 as cited in Hill et al. 2012, p.13). Gereffi and Fonda (1992) conduct a comparison of regional paths of development between four regions: Latin America, East Asia, South Asia, and sub-Saharan Africa. It is argued that “East Asia comes out on top according to almost all



indicators of economic and social development, followed by Latin America, South Asia, and at a considerable distance from the rest, Africa” (Gereffi and Fonda 1992, p.419). Cummings (1984) conducts a country-to-country comparison and draws Mexico as the best analogy to Taiwan, and Argentina to South Korea in terms of political-economic arrangements (authoritarian system, strength of the state) and industrialization process (Bolesta, 2012).

Though, it is argued, there are differences among developmental states and in the degree of system transformation in terms of democracy or dictatorship, the extent of state involvement in the economy and the strength of industrial policies, they all share an overriding growth-oriented policy objective by means of aggressive growth promotion by the state.

### **2.3 Relations among State, Business and Society**

Developmentalism is an economic ideology that legitimizes power relations and resource distribution. The developmental state discourse has created a distinctive set of relational problems among three actors, namely, the state, the market and society, which are the characterizing features of the developmental state. These interrelations among the three actors under the framework of developmental state are examined in this section.

#### **2.3.1 State-Society Relations: Embedded Autonomy**

In examining the interplay and ties between the state and society in the process of industrialization, two types of states are defined, namely, predatory states and developmental states. Following Evans (1995), the predatory states refer to the states that “extract at the expense of society, undercutting development even in the narrow sense of capital accumulation” (Evans 1995, p.12). They are characterized by

ruthlessly extracting but providing nothing of value in return. The process of the extraction of goods or others from the society is by legal or illegal means. Zaire is seen as an example of a predatory state, because Evan (1995) explains that, “[t]here are clear structural differences between predatory and developmental states. Predatory states lack the ability to prevent individual incumbents from pursuing their own goals. Personal ties are the only source of cohesion, and individual maximization takes precedence over the pursuit of collective goals. Ties to society are ties to individual incumbents, not connections between constituencies and the state as an organization” (p.12).

As illustrated in Evan’s (1995) comparative research on successes and failures of state intervention in the transformation of computer industries in Brazil, India, and Korea, the interrelation between the state and the society likely falls into two extreme patterns. In predatory states, for example, Zaire, the state elite pursues outright appropriation on the decreasing resources of the society, whereas in developmental states, Korea, for instance, the political-bureaucratic elite increases the resources in partnership with society for the benefit of both (Bolesta, 2012). The developmental state is seen as effective because of bureaucrats’ autonomy from political pressure. According to Evans (1995), the dual-dimensioned concept of “embedded autonomy” is adopted to identify the development-facilitating traits of the developmental state. It is argued that, on the one hand, the developmental state is in an “autonomous” form as its rationalized bureaucracy cannot be instrumentally manipulated by powerful rent-seeking groups outside of the state. On the other hand, it is also “embedded” because state elites are connected to social networks and other relations that bring them in close contact with prominent players in society (Wright, 1996). By virtue of the combination of “autonomy” and “embeddedness”, the state gains the capacity to formulate long-term state policies and focus on the primary objective of economic growth, and yet is sufficiently constrained by forces from society so that its actions override the national interests instead of the state elites.

### **2.3.2 State-Society Relations: Weak and Subordinate Society**

However, Leftwich (2000) holds a different view from that of Evans (1995) by emphasizing the primacy of politics that determines the concept of the developmental state, and the developmental success or failure as well as the interaction between the state and the society in developing societies. First and foremost, he argues strongly in favor of the state and its role in promoting development, stating that “[i]t seems unlikely that it is possible in the modern world for any society to make a speedy and successful transition from poverty without a state that in some respects corresponds to this model of a developmental state” (Leftwich, 2000, p.169). He then defines six major factors that shape and consolidate the developmental state (Leftwich, 2000). First, the developmental state is ruled by a determined political elite that is growth-oriented and demonstrates strong commitment and will in achieving economic development. Second, the developmental state is administered by a powerful, competent and professional and insulated bureaucracy. The state possesses a sufficient capacity to influence, set and direct the terms of operation for private sector. Third, the presence and role of civil society in the developmental state is weak and subordinate. Fourth, the developmental state demonstrates a high capacity for the effective management of private economic interests. Fifth, the developmental state exhibits an uneasy mix of repression and poor human rights records (in particular in the undemocratic developmental states). Sixth, the legitimacy of the political ruling elite is tightly linked to the state’s performance. Leftwich (2000) observes two aspects of a certain imbalance between the state and the society. On the one hand, there is a powerful state with a powerful bureaucracy that manages the private economic interests effectively. On the other hand, there is a weak society that has negligible influence on the ruling regime as it is subordinate to the latter.

Amsden (1989) validates, to some extent, Leftwich’s opinion on the unbalanced relation between the state and the society by providing an example of South Korea to argue that the government is able to consolidate its power because competing social classes are weak: “Workers were a small percentage of the population, capitalists were

dependent on state largesse, the aristocracy was dissolved by land reform, and the peasantry was atomized into smallholders” (Amsden, 1989, p.52).

### **2.3.3 State-Society Relations: Political Weakness of Rural and Working Classes**

Empirical studies further suggest that the political weakness of rural and working classes is a salient parameter involved in the developmental state-society relations. The weakness of the rural class was illustrated in the implementation of land reforms, which diminished the influence of the landlord class and the agrarian elite powers (Haggard, 1990). Rural reforms aimed at achieving two goals: eliminate rural elites as potential opposition towards state industrialization, and gain support from the rural class for state policy-making by empowering the less privileged class. Haggard (1990) argues that it is unlikely that eliminating rural elites was directly linked to the state’s capacity to implement industrialization, as the developmental state gained more freedom to manipulate without their involvement.

As for the industrial working class concerning the participation in the political process of policy making, Cumings (1984) points out that laborers were excluded from the policy-making process in the 1950s and 1960s. Haggard (1990) further states that all NICs were characterized by the political weakness of the working class, due to an inherent lack of empowerment, such as Taiwan, or repression, such as South Korea. In contrast to the control on the rural class, on the one hand, the developmental state would ensure that labor forces do not exert an extensive influence on policy making. On the other hand, the state implemented industrial policies that reduced its foreign dependency through the local production of industrialized products in order to enable it to gain support from the working class. The control on the working class might have its political and economic reasons: “political-the proximity of communist states, and therefore a somewhat increased possibility of leftist political movements outbursts within the labor force; economic- keeping the wages low, thus increasing the international competitiveness of a domestic production base” (Bolesta, 2012).

Comparing the state's dual attitude towards working and rural classes, Waldner (1999) concludes that rural and labor classes were both repressed due to a lack of political power to advance their propositions, but concurrently empowered by transferring land, making policies of important substitution industrialization. On the one hand, the developmental state has perceived that the rural and working classes needed to be controlled. On the other hand, it was seen to be very important to acquire their support for the development endeavor.

#### **2.3.4 State-Business Relations: State-Business Alliance**

The interlocks between the state and business are other prominent elements defining the developmental state, often described as state-business alliance (Robinson et al., 1998; Wade, 1990a; White, 1988). Wade (1990a) examines the role of the state as the power center in fostering development via certain incentive structures, such as fiscal and tax incentives, and the alliance between markets and public administration. He argues that business goals were likely achieved only with state support, otherwise they would not be profitable or would be highly risky. Hall and Soskice (2001) divide national political economies into two types by referencing the way in which firms resolve the coordination problems they face when implementing business projects: liberal market economies (LMEs) and coordinated market economies (CMEs).<sup>32</sup> They point out that the focus in CMEs is on strategic interaction with the state, “[f]irms depend more heavily on non-market relationships to coordinate their endeavors with other actors. [...] These non-market modes of coordination generally entail more extensive relational or incomplete contracting, network monitoring based on the exchange of private information inside networks, and more reliance on collaborative, as opposed to competitive, relationships to build the competencies of the firm” (Hall

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<sup>32</sup> Compared to CMEs, in LMEs, “Firms coordinate their activities primarily via hierarchies and competitive market arrangements. [...] Market relationships are characterized by the arms-length exchange of goods or services in a context of competition and formal contracting. In response to the price signals generated by such markets, the actors adjust their willingness to supply and demand goods or services” (Hall and Soskice, 2001, p.8).

and Soskice, 2001, p.8). The state-business alliance is based on functional industry-based criteria and the transparent environment in accordance with consistent rules and norms (Bolesta, 2012).

According to Doner et al. (2005), state-business alliance is a salient factor of the developmental state, “in which expert and coherent bureaucratic agencies collaborate with organized private sectors to spur national economic transformation” (p.328). The state works closely with the business sector to achieve developmental goals. There are distinct tasks between the state and business in the collaborative relationship. The state formulates a comprehensive industrial development plan in the national interest, whereas the business sector implements and realizes the plan by effective and efficient production as well as organizational management of the development-oriented business operations. The state-business relations are of diverse models in the East Asia region, because various business opportunities and projects are created by the state, thus the models are shaped primarily by the political ideology and national business systems (Haggard, 2004).

The dynamics of the partnership between the state and the business is articulated in different forms. As captured by Woo-Cumings (1999, p.16), who states that “the developmental state is not an imperious entity lording it over society but a partner with the business sector in a historical compact of industrial transformation.” Weiss (1995) contends that the remarkable industrial development relies on the theory of “governed interdependence.” This institutional arrangement “describes a system of central coordination based on the cooperation of government and industry. Policies for this or that industry, sector, or technology are not simply imposed by bureaucrats or politicians. They are the result of regular and extensive consultation and coordination with the private sector. Government’s developmental project does not lose out to clientelistic or sectional interests because of insulated policymaking; business does not lose out to remote and bumbling bureaucrats because of institutional connectedness” (p. 594). Likewise, Kong (2000) observes South Korea’s political economy in the 1980s as characterized by an irreversible change of power in the state-industry alliance.

He captures this as the transition from “state dominance to interdependence” (p. 108). Nevertheless, Samuel’s (1987) proposition of “reciprocal consent” seems to challenge the notion of state dominance in the process of Japanese economic development. He argues that “[r]eciprocal consent is the mutual accommodation of state and market. It is an iterative process of reassurance among market players and public officials” (p. 8). He continues, stating that “[f]or the politics of reciprocal consent, negotiation and compact are the core of business-state relations” (P. 2).

However, the state-business alliance in the context of developmental state is commonly blamed for extensive rent seeking and corruption as patronage relations are produced (Knight, 2014; Leftwich, 2000; Naughton, 2008). It is inevitable that the developmental state becomes corrupt because the role of the state in economic life is too intense to resist the huge temptations generated by fast economic growth (Leftwich, 2000). In the asymmetric relationship, the state, as the patron, provides selective access to physical goods, key resources and markets for the business sector that is subordinated and dependent. In return for receiving such benefits, the business, as the client, should provide loyalty and political support. According to Knight (2014), “[p]atronage extended beyond the state sector because private businesses had to maintain good relations with government and party officials” (p.1341).

## **2.4 Four Defining Features of the Developmental State**

Having analyzed the overall definitions, implications of the developmental state, one needs to address the following issue: how does the debate extend to China’s growth trajectory after the reform era? Based on the theoretical contributions referred to above, I will briefly summarize the universal essence of four defining features of developmental state, then extend to the analysis of China’s development path by examining how these four universal aspects of developmental state map on the late catching-up developmental state since the economic reforms.

The developmental state is an institutional structure and policy arrangement, which aims to enable underdeveloped countries to effectively catch up developed countries. The developmental state is largely defined by the interplay between four actors, the political elite, the state economic bureaucracy, the society and the business sector. This actor-based approach is summarized as four defining features of developmental states, namely, “development-oriented political leadership, an autonomous and effective bureaucracy, a production-oriented private sector and performance-oriented governance” (Meyns and Musamba, 2010, p.21).

#### **2.4.1 Development-Oriented Political Leadership**

Many scholars have observed the necessity of development-oriented political leadership associated with a powerful economic and political ideology focused on development (Amsden, 1989; Beeson, 2003; Wade, 1990; Woo-Cumings, 1999). In traditional East Asian developmental states, the political elites were able to create functional state institutions conducive to both political stability and economic growth (Waldner, 1999). The development-oriented political leadership reaches a clear consensus within the political and administrative elites over the developmental pace and directions (Pempel, 1999; Weiss, 2000). These political elites’ high level of decisiveness combined with sound judgment and sufficient economic credibility enabled them to win the trust of and achieve collaborations with the bureaucrats as well as the business sector (Huff et al., 2001, as cited in Meyns and Musamba, 2010, p.22). As for the development motivation, Amsden (1989) and Wade (1990) suggest that interests of political survival and legitimacy give rise to a developmental-oriented political leadership. Fritz and Menocal (2006) further claim that “[i]n Asia, political leadership committed to development was often motivated by regional competition, nationalism and the desire to ‘catch up’ with the West. As a result, development was regarded as a ‘national project’ of the first priority. Such determined political elites were either relatively uncorrupted or limited personal gains to non-predatory corruption which did not impede investments and the expansion of national



productivity” (p. 8-9). In conclusion, the most important merit of developmental state is not only attributed to policy design and implementation but also largely the strong political commitment to promoting “government-guided development” in accordance with the long-term development strategy (Wade, 1990a, p. 487).

#### **2.4.2 Autonomous and Effective Bureaucracy**

In general, the autonomy of bureaucracy in developmental states is derived from a Weberian tradition that adopts a meritocratic recruitment approach, provides promotion incentives, creates rationality and guarantees high levels of prestige and legitimacy to bureaucratic officials (Evans, 1997; Johnson, 1982, as cited in Meyns and Musamba, 2010, p.23). The recruitment system associated with strong promotion incentives creates effective state bureaucracy that remains extensively insulated and independent in the process of economic and development policy making and implementation as well as institutional arrangements. To a large extent, the effective formulation of a long-term development strategy is by competent economic bureaucrats and technocrats. Most notably, although the state bureaucracy protects itself from particularistic private sector interests, it forges business alliances between the state and business sector in a productive manner (Beeson, 2004, as cited in Meyns and Musamba, 2010, p.23). In pursuit of the development objectives, the state bureaucracy creates both tempting incentives and tough penalties to promote private cooperation with national goals, which is referred to as “disciplined support” (Weiss, 1995, p. 607) or “carrots and sticks” approach (Leftwich, 1995, p.412). However, it is noteworthy that the state is self-disciplined to prevent predatory, disruptive rent-seeking behavior or the abuse of power (Amdsen, 1989, as cited in Meyns and Musamba, 2010, p.23).

More importantly, to maintain close control over the business, the state demonstrates great strength and capacity for institutional arrangements in terms of powerful policy instruments and functional state structure. These institutional arrangements effectively

enable the bureaucracy to intervene in the private sector and influence its decision making by setting short-term and long-term trade targets, tight regulations with regard to monitoring and evaluation systems, and providing industrial subsidies. As a result, the state gains enormous power from the business sector through the pervasive control of banks and other financial institutions (Chang, 2006). In summary, the responsibilities assumed by the state bureaucracy, as Amsden contends, “provide supporting evidence for the proposition that economic expansion depends on state intervention to create price distortions that direct economic activity toward greater investment” (Amsden, 1992, p.14, as cited in Meyns and Musamba, 2010, p.24).

#### **2.4.3 Production-Oriented Private Sector**

A production-oriented private sector is deemed to be central to accelerating the progress of industrialization and modernization that occurred in the East Asian developmental states (Booth, 1999, p.306). State intervention in these countries marked a different type of capitalism, in which the primary purpose of intervention was to promote the interests of the business sector, create conditions for capital accumulation and productivity improvement (Amsden, 1989, as cited in Meyns and Musamba, 2010, p.24). In order to achieve the objective, the states devise a broad range of state instruments to enhance the competitive capacity of domestic enterprises in domestic and global markets by upgrading manufacturing technology, research and development, and management skills between themselves and highly industrialized nations. Again, the analysis reflects the theory of the developmental alliance that the state creates partnerships between the state and private sector in the form of “reciprocal consent” (Samuels, 1987), “governed interdependence” (Weiss, 1995), “from state dominance to interdependence” (Kong, 2000, p.108) or likewise “from dominance to symbiosis” (Kim, 1997, p.45-6).

#### **2.4.4 Performance-Oriented Governance**

The performance-oriented governance of the developmental state reflects not only the state's embeddedness in the society (Bolesta, 2012), but first and foremost the commitment to promoting socioeconomic equity for both the ruling elites and the citizens (Meyns and Musamba, 2010). On the one hand, the institutional mechanisms enable the society to engage in the public participation in the creation of laws and regulations. In other words, the political legitimacy partly comes from the citizen's influence on the process of policy making in developmental states (Bolesta, 2012). On the other hand, more crucially, the "growth with equity" (Ohnesorge 2007a; 2007b; Peng and Wong, 2004) approach has highlighted the ruling elites' legitimacy derived from industrial modernization aspirations and performance, more precisely their achieved social outcomes. As captured by Chang (2006), "the achievements of the (East Asian) region's economies do not stop at income growth. Their records in terms of improvements in infant mortality, life expectancy, educational achievements, and other indicators of 'human development' have also been very impressive, even considering their income growth" (p.1). Indeed, the state achieves a particular developmental legitimacy based on the developmental results evaluated by the citizens rising standards of living (Bolesta, 2012, p. 133; Johnson, 1987, p.143; Leftwich, 2008, p. 16). As observed by Meyns and Musamba (2010), the most significant indicator of evaluation is the ruling elites' high levels of commitment to poverty reduction. The rapid industrial growth in East Asia was paralleled by a favorable pattern of growth with equity through a series of mechanisms, namely, income equality, low unemployment and the near elimination of grinding poverty (Deyo, 1987). As a result, despite having a poor human rights record, ruling regimes in developmental states tend to enjoy the widespread support of their constituencies and a high degree of legitimacy to stay in power. As Johnson (1999, p.53) concludes, "[t]he source of authority in the developmental state is not one of Weber's 'holy trinity' of traditional, rational-legal, and charismatic sources of authority. It is, rather, revolutionary authority: the authority of a people committed to the transformation of their social, political, or economic order. Legitimation occurs from the state's achievements, not from the way it came to power."

## **2.5 China as a Developmental State**

As an emerging industrialized country, China's development trajectory has been extensively examined, in particular the notable change in China's political economy since the reform era. Compared to the historical East Asian developmental states, such as Japan, South Korea, Taiwan, the debates have focused on how China fits into the discussion on the concept of developmental state (Baek, 2005; Blecher, 1991; Bolesta, 2012; Breslin, 1996; Howell, 2006; Huang, 2008; Knight, 2014).

China's contemporary growth trajectory has demonstrated that the state plays a very positive developmental role in achieving developmental objectives. In view of the nature and extent of state intervention in the overall socioeconomic development since the reform period, the prevailing argument is China is a developmental state (Baek, 2005; Beeson, 2009; Knight, 2014; Nee et al, 2007; Oi, 1999; Whiting, 2001). However, Breslin (1996) challenges the argument by claiming that "China's developmental trajectory has been to a large extent dysfunctional" (p. 689). He argues that three factors - political constraints, local initiatives, and external economic interests- explain the obstacles to effective long-term economic policy making that influenced the Chinese reform process. Specifically, this includes the decentralization of fiscal responsibility and power grants autonomy to provinces to design their own development-related policies to respond to numerous and often conflicting new central initiatives. Moreover, the inter-elite discord result in a dysfunctional development, which in turn generated further unexpected developments that have militated against the adoption of any coherent program or model for reform- either internal or external (Breslin, 1996, p. 690). Howell (2006) further observes that "[t]he conjuncture of specific political, socioeconomic and institutional processes, both internal and external, undermines the case for China as a developmental state" (p. 274). China's transformation, characterized by a high degree of economic decentralization and intensifying global competition, has resulted in an empirically

observed phenomenon of competition among local authorities. “The intense rivalry between local economic actors for markets, resources, and foreign investment not only produces contradictory developmental outcomes - on the one hand, economic growth and rising average annual per capita incomes, and on the other hand exploitative working conditions, environmental degradation and increasing inequality- but also undermines the political and administrative capacity for fundamental social and economic transformation” (Howell, 2006, p. 274). Indeed, China is a polymorphous state, it lies between predatory and developmental states, like Brazil and India, because of the displayed elements of efficiency and inefficiency, control and chaos, relative autonomy and clientelism, and neoliberalism and neo-corporatism (Howell, 2006, p. 274-5).

However, the majority of analysts claim that China is a developmental state. Among them, White (1984) and White and Wade (1988) identify pre-reform China characterized by the state-command economy as a socialist developmental state. “The key features of the socialist developmental state are the virtual elimination of private industrial capital, all-pervasive controls over the economy, and a state that, at least initially, represents the interests of a revolutionary coalition” (White, 1984, p.103, as cited in Howell, 2006, p.276). However, the private sector that is deemed necessary in the production and state-industry alliance, to a large extent is absent in the pre-reform socialist economies. In fact, the state assumed considerable economic responsibilities by becoming the main economic actor involved in a wide range of activities that included not only social and economic institutions but also ownership and management of productive industry.<sup>33</sup> In this sense, it is argued that China prior to the reform period is not a developmental state (Bolesta, 2012, p.52; Howell, 2006, p.276; Knight, 2014, p.1336). However, it is necessary to acknowledge that Mao Zedong’s socialist legacy of central planning enhanced the political capacity for the formation of a developmental state since the Dengist era. Indeed, China in the time of market economy reforms is definitely a developmental state even though it is reflected in

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<sup>33</sup> For detailed analysis of China’s development process during the state-command period, see Christiansen and Rai, 1996, p. 121-148, 185-214; Bolesta, 2012, p.84-87.

proliferating alternative notions such as the entrepreneurial, corporatist, market-facilitating, regulatory and rent-seeking state based on the analyses of particular local state formations.<sup>34</sup> Concerning the growing complexity of power structures and central-local relations, Liberthal (1995) highlights the “fragmented authoritarianism” that on the one hand, “authoritarian in the discipline demanded from subordinates and the lack of real protections for the population or opportunity for them to articulate their interests; and (on the other hand), fragmented in that territorial and functional lines of command intersected in hopelessly complex ways” (p.82). Montinola et al. (1995) characterize the new political system as “federalism, Chinese style” that “provides considerable political protection for China’s reforms, including limits on the central government” (p.52). Using this term, they also explain the diverse effects of economic competition (p.65–66).

### **2.5.1 Experiences and Lessons Learnt**

How does China form its growth strategy and policy making through learning from the aforementioned issues and how these four defining features of developmental state map on to China? According to Trubek (2008), the key feature of a developmental state is its ability to foster the process of learning and discovery as the central element for a successful developmental state. In fact, China’s successful development path in terms of transition to the market system since the late 1970s is greatly attributed to its gradual and incremental strategy (Miller, 1996; Naughton, 2008; Svejnar, 2008; Wong, 2003). Compared to the dismal performance of the economic reform programs of the former Soviet Union and Eastern European countries which are characterized by the political regime change process, China adopted a gradualist approach to promoting the economic reform. In particular, the lessons derived from the transformation experiences of Soviet Union suggest that “at a certain primitive level of political institutionalization, democratic politics, such as that currently prevailing in Russia,

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<sup>34</sup> These competing notions will be analyzed in the subsequent section of Local State Developmentalism.

can be a double-edged sword for the practitioners of reform. The defeat of Yeltsin's supporters in the parliamentary elections of December 1993 reinforced this picture of the weakness of democratic politics in Russia" (Miller, 1996, pp.93-94). Indeed, China has followed closely the East Asian tradition of "economic growth first and political change later." Successful economic growth is used to boost the legitimacy of the political leadership, which is in turn under strong pressures to achieve good economic performance. As a result, it has avoided the reform failures encountered by former Soviet Union and Eastern European countries (Wong, 2003, p.128).

Concerning China's industrial policy making, it has largely learned from the experiences of its small neighbors, the traditional East Asian developmental states in terms of Japan, South Korea, Taiwan, Hong Kong and Singapore. As Lieberthal (1995) notes, China's leadership "has pursued an export-led growth strategy since the reforms got well under way. It has developed labor-intensive industries, primarily along its eastern coast, to process items that are then sent into the international market. The profits from this export sector have paid for the technology and other imports have played a major role in accelerating the country's economic growth" (p.259). The implications of this new approach to gaining technology, capital, managerial knowledge, and access to markets through participation in the international economy were far-reaching. The special economic zones (SEZs) have been developed at selected places along the coast. These zones, utilizing a mix of the models developed in South Korea and Taiwan, offered exceptional tax treatment and other concessions to foreign firms to invest in those areas (Lieberthal, 1995, p.150).

### **2.5.2 Application of Four Defining Implications**

This study suggests that China is a developmental state since the reform era and is characterized by ultimately far-reaching state-led development endeavors. China's industrialization has been guided by developmentalism: a political creed that advocates state-guided markets in the national interest. The developmentalist creed

explicitly rejects the self-regulating market ideal, and the noninterventionist state, calling instead for cooperative relations among government and business within the framework of a developmental state. I will examine the applicability of the four defining features illustrated in the preceding section, namely development-oriented political leadership, an autonomous and effective bureaucracy, a production-oriented private sector and performance-oriented governance since China's reform era.

*Development-Oriented Political Leadership.* The Chinese political system is characterized by its authoritarian form of a rather strongly coercive feature. There are three reasons why Deng Xiaoping's new leadership becomes development-oriented after December 1978. "First and foremost, the loss of political legitimacy during the years of economic stagnation and political upheaval required an improvement in living standards to restore and solidify political support for the CCP. Failure to promote rapid economic development would mean economic stagnation, social tension, and political decline" (Knight, 2014, p.1336). Thus the top leaders crafted policies that were consistent with both their own political strategies and the overriding political imperative of regime survival (Naughton, 2008, p.106). Among these policies, economic reform is an attempt to regain the hegemonic authority of the CCP by abandoning the Maoist notion of development as a political struggle and attempting to accelerate economic growth. Consequently, it would provide a new form of legitimacy for the regime, based on its ability to deliver rapid improvements in social services (White, 1993, p.11). Second, the catching up ideology drives the new leadership to catch up with the Western capitalist powers and its advanced neighbors as well, such as, Japan, South Korea and Singapore (Bolesta, 2012; Knight, 2014). Third, the chaos of the Cultural Revolution had weakened the capacity for central planning (Naughton, 1995, as cited in Knight, 2014, p. 1336). Consequently, developmental state ambitions with regard to specific growth-oriented objectives were pursued by the political elites in order to restore social order and maintain political legitimacy. Ever since, China has embarked on the successful transformation, for example, price liberalization, banking system institutionalization, private property and private means of production



legalization.<sup>35</sup> Indeed, the transformation project was supported by sustainable visions of development. The main strength was the overriding policy objective to achieve rapid economic development by means of active statist intervention in the economy.

*Autonomous and Effective Bureaucracy.* Other than power dispersal and regularization of political life, one important characteristic of Deng Xiaoping's reform project is reflected in the professionalization of administration (Christiansen and Rai, 1996, p.106). In fact, the state (economic) bureaucracy reflects the fact that the state not only assumed a huge economic role, but also had the professional manpower, regulatory capacity and administrative ability to efficiently carry out the tasks at hand. The nomenklatura system has introduced greater professional economic bureaucrats and technocrats through the use of educational qualifications, cadre training and performance evaluation as an incentive system that rewards the achievement of state objectives and career promotion.<sup>36</sup> On the one hand, although predatory behavior in terms of corruption or rent-seeking greatly undermined the insulation at administrative levels, to some extent, the state is in the process of achieving Evans' embedded autonomy by enjoying extensive autonomy from the society and certain groups of particular economic interests (Bolesta, 2012). On the other hand, the state has created a strong, reliable, predictable and competent state (economic) bureaucracy in policy making and implementation, which is the central key attribute to the state assumed control of development and national economic planning. For instance, the National Development and Reform Commission (NDRC)<sup>37</sup> as the most powerful form of pilot economic bureaucracy assumes the role of a paramount government institution

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<sup>35</sup> For detailed analysis of China's transformation during the reform period, see Christiansen and Rai, 1996, p.216-250.

<sup>36</sup> The cadre evaluation system will be analyzed in more detail in Chapter 3.

<sup>37</sup> According to Bolesta (2012), "NDRC finally took its present shape after the State Planning Commission had been renamed as the State Development Planning Commission (SDPC) (1998) and had merged with a part of the State Economic and Trade Commission (SETC) in 2003. [...] NDRC is a macroeconomic management agency under the State Council, which studies and formulates policies for economic and social development, maintains a balance of economic aggregates and guides the overall economic system restructuring" (p. 152). The main functions of NDRC, see *Guojia fazhan gaige wei zhuyao zhize* (National Development and Reform Commission). <http://www.ndrc.gov.cn/zwfwzx/jj/> (accessed 5 October 2015).

supervising the developmental directions and modernization efforts and enjoys a relatively privileged position. On top of that, the Ministry of Commerce (MOFCOM) is considered to be another crucial agency that intervenes and controls certain developmental aspects by formulating development strategies, guidelines and policies of domestic and foreign trade and international economic cooperation.<sup>38</sup> Indeed, as Christiansen and Rai, (1996) conclude, “with increasing autonomy and assertion of sectoral and local interest following the reforms in the 1980s, the large heavy industrial ministries, [...] and the provinces constitute important and powerful constituencies to whose interests the top leaders in the Political Bureau are accountable” ( p.110).

*Production-Oriented Private Sector.* Although privatization of ownership<sup>39</sup> was never considered seriously by the Chinese leadership, the private sector has grown in a parasitic coexistence with the state sector since the economic reform era (Christiansen and Rai, 1996, P.225). However, it is noteworthy that the state adopted active policies to support the emerging private economy and promoted great incentive mechanisms to encourage private investment. As observed by Haggard and Huang (2008), “[t]he party made a strategic decision in the early 1980s to liberalize the domestic private sector and orient state-owned banks toward supporting the domestic private businesses, at least on the margin” (p.368). Consequently, despite the state sector continues to occupy an important role in the Chinese economy, the private sector has played a significant role in the national development process, “the rate of return on investment in privately controlled industrial firms has been higher than in state-controlled industrial firms and that marginal private investment has contributed more to growth” (Knight and Ding, 2012, as cited in Knight, 2014, p.1341). Although the private firms

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<sup>38</sup> MOFCOM is the descendant of The Ministry of Trade (1949-1952). It then went through several phases of transformation: the Ministry of Foreign Trade (1952-1982), the State Import and Export Administration Commission, the State Foreign Investment Administration Commission (1979-1982), the Ministry of Foreign Economic Cooperation and Trade by merging the State Import and Export Administration Commission, the State Foreign Investment Administration and other two ministries (1982-1993), renamed as the Ministry of Foreign Trade and Economic Cooperation (1993-2003) and finally MOFCOM (2003). The main functions MOFCOM, see Ministry of Commerce. <http://english.mofcom.gov.cn/column/mission2010.shtml> (accessed 5 October 2015).

<sup>39</sup> A detailed study of the privatization of ownership will be presented in Chapter 4.

are more effective agents for implementation of the state's development strategy in delivering the development results, as they have more clearly defined targets and beneficiaries, China, at least at state level, seems to ignore this fact by choosing to forge alliances with state-owned enterprises (SOEs) in a state-guided industrialization because they are easier to control and influence (Bolesta, 2012) and the political logic of reform aimed to safeguard and promote the public ownership economy (Nee and Oppen, 2012, p.8). 512 large SOEs were designated as priority companies by government industrial policy in the mid 1990s (Baek, 2005, p.489). In this sense, the frames for the state-private business alliance may not be yet fully formulated in China and the close interplay between the state and SOEs is often blamed for the rampant corruption of this institutional arrangement. However, it is argued that the emergence of private enterprises has the tendency to "result in them taking over the targeting policy implementation in, at least some less politically sensitive sectors, once they have gained the authorities' consent. The policy of building the national economy's innovation capacities, very important for the successful contemporary development, can be realized (under state guidance) via private companies" (Bolesta, 2012, p.193). Indeed, the state-private sector alliance beyond the abstract macro level unfolds a dynamic and divergent interaction as captured by Oi (1999) as "mutual dependence" (p.98) and "private-public symbiosis" in localities (p.134).<sup>40</sup>

*Performance-Oriented Governance.* Due to the lack of democratic procedures, China, to some degree, seems to have maintained a relatively high level of insulation from the society. However, the level of the state's embeddedness in society seems to be increasing, partly as a result of the fact that consultative and deliberative institutions have been developing in China. Among the consultation channels, an increasing number of public hearings have provided citizens with opportunities to express their opinions on a wide range of issues. This practice derived from village meetings/discussions held by village representatives in the middle and latter 1990s has spread into urban residential communities and finally developed at the national level.

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<sup>40</sup> The state-private sector relationship will be examined in more detail in the following section.

Since 1996, several national laws have introduced public hearings into the process of decision-making on regulations and laws.<sup>41</sup> As a result, more than 50 cities have held legislative public hearings (Fishkin et. al, 2008, p.463). In 2005, the first far-reaching experiment of deliberative institution was successfully invented in Zeguo Town, Wenling City of Zhejiang Province which “represents a systematic public decision-making mechanism that consists of expert feasibility studies, public participation through Deliberative Polling, government consultation, and a final decision made by Zeguo’s People’s Congress” (Fishkin et. al, 2008, p.472). This deliberative institution as a form of democratic consultation does not change the political structure and threaten the one-party state, but has a broad implication for the central leadership. Hence it was officially recognized in the 18th CCP National Congress Report (November 2012).<sup>42</sup> As a whole, the public consultation process is strongly evidenced in the increasing embeddedness in China, which is undergoing institutional transformation, although the influence might be limited, it allows the nation’s high level of mass participation in systemic institutionalization.

In addition to mass participation in decision-making, social development is another important indicator to measure the developmental state’s governance outcome by their constituencies. Indeed, China has achieved a staggering degree of poverty reduction since the rural reforms which dismantled Mao Zedong’s egalitarian policy and promoted China’s economic development. The World Bank estimates the number of people living in poverty has declined from roughly 270 million in 1978 to 97 million in 1985. To address the poverty problem, the state launched a series of programs, for example, the 8-7 Poverty Eradication Program in 1994, which aimed to solve the issue of 80 million people in poverty within seven years. By the end of 2000, the target was

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<sup>41</sup> According to Fishkin et. al (2008), for example, “[i]n 1996, the first national law on administrative punishment—a law that regulates the imposition of fines—introduced an article on holding public hearings before punishments are imposed. Article 23 of the Law on Price passed by China’s National Congress in December 1997 specified that the price of public goods must be decided through public hearings. The Law on the Legislature, passed in 2000, followed Article 23 and required public hearings as an integral part of the decision making on all legal regulations and laws in China” (p.463).

<sup>42</sup> The full text of the report, see Xinhuanet. [http://news.xinhuanet.com/english/special/18cpnc/2012-11/17/c\\_131981259.htm](http://news.xinhuanet.com/english/special/18cpnc/2012-11/17/c_131981259.htm) (accessed 5 October 2015).

mostly fulfilled, with only 27 million people living in poverty, located mostly in very poor geographical and climatic conditions (Wang, 2007, p.218-9). As captured by the World Bank (1983), “[n]onetheless, and despite slow growth of the average level of consumption, China’s most remarkable achievement [...] has been to make low-income groups far better off in terms of basic needs than their counterparts in most other poor countries. They all have work; their food supply is guaranteed through a mixture of state rationing and collective self-insurance; most of their children are not only at school, but being comparatively well taught; and the great majority have access to basic health care and family planning services. Life expectancy-whose dependence on many other economic and social variables makes it probably the best single indicator of the extent of real poverty in a country [at 64 years]-is outstandingly high for a country at China’s per capita income level” (p.11).

However, both the increase in welfare and reduction in poverty have been extremely uneven, inducing the income disparities among different groups and regions. The World Bank (1997) “estimates that, in 1981, China’s Gini coefficient was 28.8, but by 1995, it was 38.8. It was still lower than in most Latin American, African and East Asian countries, and similar to that in the United States, but higher than in most of the transitional economies in Eastern Europe and many high-income countries in Western Europe” (as cited in Zheng, p.27). Consequently, the rising disparities between the rural and the urban and across the regions have weakened the state’s social governance capacity. Recognizing the issue of economic imbalance, the ruling elites responded with developmental strategies under the leadership of Hu Jintao. “Indeed the concept of ‘scientific development’ and ‘people-centered development’ (*yi ren wei ben*) introduced at the 3rd Plenary session of the 16th Chinese Communist Party Central Committee (October 2003) marks not only a commitment to economic development but also a shift away from a unitary focus on growth to a ‘balanced’ approach which takes into account environmental and equity issues” (Howell, 2006, p.283). The balanced approach is reflected in the form of five coordinated development strategies (*wuge tongchou*), including: (1) coordinating development between urban and rural areas; (2) coordinating development of regions; (3) coordinating between economic

and social development; (4) coordinating economic development and environmental sustainability and (5) coordinating domestic development with opening up to the outside world.<sup>43</sup>

In a nutshell, it is argued that the outcome-oriented governance in China has greatly bolstered the ruling elites' power and, more importantly, facilitated them to establish developmental rule. In turn, the leadership in such regimes that depends on the support of their constituencies ensures the rational allocation of huge amounts of public resources for development purposes conducive to performance-oriented governance, enhancing development endeavors in the process.

### **2.5.3 Local Interventionist State: Local State Entrepreneurial-Developmentalism**

Having acknowledged the prominent interventionist role of the central government in guiding to China's successful economic and social development, this section will extend the application of the concept of the developmental state beyond the abstract macro level by casting local government in the lead role of the development process. This is the focus of the present study, and investigating the micro-level institutional arrangements is urgent because: "the standard definition of a developmental state assumes the central state to be the prime actor. All accounts of developmental states focus their analyses on central policy elites, particularly in the economic domain. Such an approach removes from view the politics of local governments and their relations to the centre, presumably because it is assumed that they are inconsequential to the realization of central objectives and/or that they will automatically comply with directives from above" (Howell, 2006, p.283). In fact, after recognizing its inability to steer growth from the center, the Chinese state has gradually decentralized information, policy powers and authority to local governments since the early 1980s (Chung, 1995).

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<sup>43</sup> See *Zhongguo gongchandang dishiliujie zhongyang weiyuanhui disanci quanti huiyi gongbao* (Full Text of the Communiqué). Website of China.com.  
<http://www.china.com.cn/chinese/zhuanti/sljszqh/421625.htm> (accessed 5 October 2015).

In particular, the inherited institutional constraints contained in the fiscal decentralization and cadre evaluation system have greatly reshaped local government's behavior and the relations between central and local. Indeed, local governments were able to retain a greater portion of their revenues and mobilize resources outside of the budget through private and foreign investment and various ad hoc charges, were thus less dependent on the central state (Whiting, 2001).

It is noteworthy that mounting alternative notions have emerged in the analysis of the concept of the developmental state in the local state formations during the reform period, such as the "developmental state" (Blecher, 1991), "entrepreneurial state" (Blecher, 1991; Duckett, 1998), "local corporatist state" (Oi, 1995;1999), "the regulatory state" (Shue, 1995), "the dual developmental state" (Xia, 2000), "the clientelist state" (Pearson, 1997; Wank, 1995), "the market-facilitating state" (Howell, 1993), the "rent-seeking state" (Wedeman, 2003) and "the predatory state" (Bernstein and Lu, 2000). The multiplicity of terms reflects less the perspectives of different schools of political economy and more empirical observations of the changing nature of local states, their relations and the extent of these to the economy and society, as well as relations to the central state and finally the growing complexity of state structures and processes in the context of global integration, interest pluralization and decentralization (Howell, 2006, p.279).

Baum and Shevchenko (1999, p.345) develop a matrix to classify the local state's intervention in local economic activity into four modes, namely, entrepreneurial, clientelist, predatory and developmental. In accordance with the four modes, this section first conceptualizes the four formations of local states in China, simultaneously classifying the above mentioned alternative notions into the four modes and then developing the theoretical framework to examine the core of the case studies of this thesis, which focuses on the relationship between local states and the private sector.

*Entrepreneurial states* describe the behavior of local states that are profit-seeking oriented, and more crucially, the state agents and bureaucrats that intervene in business

directly and independently. In other words, the state itself becomes an economic actor, engaging directly in risk-taking business and investment, creating new enterprises, procuring finance and competing for business with other bureaux (Blecher, 1991; Duckett, 1998). In entrepreneurial states, officials' orientation to market activity would cause them to ignore or even exacerbate inequality and developmental imbalance because officials simply use the resources or profits at their disposal for their own purposes such as maintaining the bureau by covering administrative and salary costs. As Blecher (1991, p.288) observed, "[t]he [government building] was brand new, and sported automated doors, a mirrored, gold-lit lobby, carpet, modern furniture, and a television and refrigerator in each room. And [the] motor pool [is] full of Japanese cars". The outcome of entrepreneurialism could occur either because of the pure operation of market forces or because state bureaux could exercise more market power than the more autonomous enterprises with whom they might compete (p.269). To some extent, the entrepreneurial state connects to private enterprises, and its incentives are tied tightly to increased output/productivity.

In *clientelist states*, officials, acting as powerful patrons, promote and participate in the benefits of profit-making activity through personalized connections and particularistic exchanges with entrepreneurs in their localities (Blecher and Shue, 2001, p.368). Relations between patrons and clients have been stably established over time, which "involves an imbalance of power between official patrons and entrepreneurial clients, [and][...] the exercise of discretion by officials in allocating resources and opportunities, and it is embedded in personal ties" (Wank, 1995, p.155). In addition to access to profits, local bureaucracy interferes with or obstructs private business in many ways, such as the administrative measures, sanctions and policy formulations that emanate directly from the central state. In this respect, local officials make discretionary decisions as to whether to protect entrepreneurs from these hazards. Wank (1995) further distinguishes dependent clientelism from "symbiotic clientelism": "Dependent clientelism was the foundation of what Michael Mann would call the state's 'infrastructural power': its ability to penetrate and coordinate society. Clients helped officials mobilize compliance with central policies and directives. Clientelist



networks also created social cleavages between clients and nonclients, inhibiting the development of organized opposition to the state. [...] The key change from the earlier form of [dependent] clientelism is that the degree of client dependence is greatly reduced, as the entrepreneur-clients have resources upon which officials now also depend” (p. 153-5). In other words, entrepreneurs depend on local governments for licenses, tax benefits, access to resources, protection from predators, and so forth; cadres, in turn, get kickbacks, favors, jobs for relatives, and access to profits. Obviously, symbiotic clientelism undermines the institutional authority of the state (Baum and Shevchenko, 1999, p.350). In summary, as a powerful patron, the clientelist state closely connects to private enterprises but its interests may not be strongly tied to increased output/productivity, compared to the entrepreneurial state. In other words, the developmental alliance between local states and the business sector is very weak or negligible, if applicable.

*Predatory states* are usually connected to the behavior of rent-seeking or corruption. Officials in this context do not intervene in business either directly or indirectly but utilize their powers instead to extract unproductive rents from producers and entrepreneurs through exorbitant fees, levies and fines (Blecher and Shue, 2001, p.368). The primary objective of the predatory state is to bolster the local ruling elites’ power and to facilitate their self-enrichment or predatory interests. Regimes under predatory rule are based on intense personalized ties and thus are not conducive to independent private business growth. Obviously Wedeman’s (2003) “rent-seeking state” resembles the notion of the predatory state. He argues that “institutional anarchy and bureaucratic rent seeking, manifested in the form of local protectionism, crippled many of the monopoly and monopsony structures left in place during the first two stages of reform. [...] Local governments, mostly at the subprovincial level, usurped the monopsony and monopoly authority granted them as agents of the center and which were supposed to control the setting of prices and allocation of rent-producing commodities and used their power to ‘steal’ the center’s rents” (Wedeman, 2003, p.18). As a result, local governments engage in extensive predatory rent seeking to enrich themselves either by selling undervalued commodities on the black market or setting

up processing plants locally under their own sponsorship (p.74-5). Another ultimate predatory case is identified in a thriving locality, Daqiu Village, which rose to become a national model because Yu Zuomin, as the paramount Party secretary, took advantage of reforms to turn what had been an extremely poor village during the Maoist era into one of China's richest villages during the 1980s (Lin and Chen, 1999). However, the predatory abuses are evidenced in the local elite's ultimate control of the assets of all enterprises and through flagrant corruption. As representative of the Party and village, Yu abused his political power to control economic and social resources, even though his village provided the best social welfare at that time. This predatory behavior led to the further erosion of local government power (Lin and Chen, 1999, p.166). In a nutshell, the predatory state has a very weak connection with the business sector, simply through intense personalization of authority and its incentives are not tied to development outcomes. There is thus no developmental alliance between local governments and the business sector.

*The developmental state* seems to comprise a large number of alternative notions, such as the market-facilitating state (Howell, 1993), the dual-developmental state (Xia, 2000) and the regulatory state (Shue, 1995). In addition, Baum and Shevchenko (1999, p.350) even included Oi's (1995; 1999) model of "local corporatist state" as a variant within the category of developmental state to take account of. These terms further refined the concept of the developmental state to take account of the changing politico-economic circumstances at the local level. Compared with the entrepreneurial state, the developmental state does not engage in economic activities directly, instead it is devoted to creating an enabling and facilitating environment for independent economic enterprises and is more likely to be capable of pursuing goals of balanced growth and economic equality. For instance, Blecher and Shue (1996) demonstrate the commitment of county cadres to, and how they use, local resources in terms of county institutions and the relationships between higher-level authorities and the townships and villages below them for the purpose of balanced local economic growth (Blecher and Shue, 1996). It is argued that local developmentalism is a result of a combination of ideological and historical factors that in turn underpin a deep-seated resistance to

entrepreneurial profit-making either for self-gain or on the part of state institutions (Blecher and Shue, 1996, p.42, as cited in Howell, 2006, p.280).

As far as various patterns of the developmental state are concerned, the “dual developmental state” highlights the combination of a central reformist leadership and developmentalist governments at the provincial level which both had a mutual interest in fostering rapid growth (Xia, 2000). While in a “market-facilitating state”, the Chinese state appears to have evolved to enable itself to maintain the control or supervision of, and participation in, the process of opening up by improving the technical proficiency and professional skill of its bureaucrats (Howell, 1993). “The regulatory state” is also seen as the developmental state, but reflects the extent to which the state intervenes or involves in economic development is very small or minimal. Rather, it engages in the attempt to wrest the control of business sector by exercising various forms of statutory regulation. In Shue’s (1995) case study of Xinji City, “[l]ocal state authorities move out [...] in greater force to apply newly crafted regulatory and administrative-coercive controls in the very social spaces that were so lately liberated from direct state command in respond to the uneven economic growth, social strain, and urban sprawl” (p.112). In the regulatory mode, the local state adopts a political strategy to control and co-opt private traders, coping with the challenging consequences of economic reform. In all respects, the state apparatus used by the locality is not directive, but primarily regulatory in nature (p.97).

Oi’s (1995; 1999) “local corporatist state” reflects a powerful pattern of “local decentralized developmental state” (1995, p.1149) and “entrepreneurial developmental state” (Oi, 1995, p.1139). She makes use of the analogy that compares the roles and behavior of two dimensions: leadership and resources of county, township and village governments to that of corporate and regional headquarters and companies, as one component within a larger and diversified corporation (Oi, 1995, p.1138-1139; Oi, 1999, p.103-115). Based on this “corporate-like organization” (Oi, 1995, p.1132), local officials are able to foster local economic growth by supporting local collective industrial enterprises through the provision of information, access to materials and

technology, and through the selective redistribution of resources from wealthier sister enterprises to start-up enterprises or to less successful village enterprises that absorb local surplus labor force or the enterprise carries prestige thus gives “face” to the village (Oi, 1995, p.1139–1141). The term of “local corporatist state” is in fact akin to the concept of “entrepreneurial developmental state”. As Oi (1995) points out, “[t]he degree to which officials get involved in product development, market research and the acquisition of technology suggests that this is not the usual provision of bureaucratic service, but the activity of an entrepreneurial developmental state” (p.1139). They both highlight the combination of entrepreneurial and governmental roles of local governments. However, the former reflects the dynamics of a “large multi-level corporation” governmental structure; the latter underlines that local state is driven not only by economic and profit motives but also by social interests, such as the considerations of employment provision (Oi, 1995, p.1142). Moreover, Howell (2006) suggests that it is more appropriate to use the term “corporate state” rather than “corporatist state” because the latter refers to a specific system of interest representation, usually contrasted with pluralism (p.281).

Building on the theoretical formations of local state, in particular inspired by Oi’s “local corporatist state”, I suggest “Local State Entrepreneurial-Developmentalism” as a concept with which to account for the role of local cadres in leading the socioeconomic development and dynamic interactions between local state and private sector in the case study of Fugu County. There are three reasons that justify why I discard Oi’s “local corporatist state” rather than develop the local state entrepreneurial-developmentalism for further analysis of local cadres’ behavior. First, “local corporatist state” was embedded in the ambiguous property rights context that granted local governments new vested rights over fiscal surplus extracted from the collective-dominant rural industries beginning in the 1980s. Nevertheless, the transformation of collective property rights to private ownership has fundamentally reformulated local governments’ strategy of socioeconomic development since end of the 1990s. The relatively clearly-defined private ownership has deprived the local cadres of property rights over fiscal surplus but enhanced their motives for expanding

the local tax base due to the revenue-sharing fiscal system.<sup>44</sup> Second, the “local corporatist state” was built on large and multi-level governmental organizations that consisted of county, township and village governments in the 1980-90s. However, the fiscal division system took effect in 1994, and the privatization of TVEs throughout the 1990s have greatly hollowed out the township and village governments as “fully fledged economic actors” (Oi, 1995, p.1137) in the 1980s.<sup>45</sup> Unlike the township and village cadres who held prominent positions in the township/village-run corporations during the collective ownership period, the power of township and village cadres has shrunk considerably, leaving room for private enterprises. They have little direct control over the management of economic activities. Furthermore, as the legacy of decollectivization of agricultural production characterized by the household responsibility system for agricultural production adopted in the early 1980s, the abolition of agricultural taxes in the early 2000s has dramatically intensified the township and village governments’ financial difficulties. Indeed, the township and village cadres are tightly constrained to rely on the transfer payments and fund appropriation from upper authorities through the fiscal system.<sup>46</sup> Under this circumstance, township and village cadres are less engaged in economic activities but enhance their capacity to provide bureaucratic services for socioeconomic development. As a consequence, the three-layer corporate-like hierarchical structure has collapsed in the evolving institutional environment characterized by private ownership. Indeed, in the case of Fugu County, a new economic intervention structure is emerging horizontally. The strong grip of power on the private sector is aggregated primarily among the county level officials. Third, I use local state entrepreneurial-developmentalism, which best blends together entrepreneur-like profit-seeking behavior and balanced socioeconomic development consideration, to examine the development model and the relations between the local state and the private sector. According to the matrix created by Baum and Shevchenko (1999), both the terms

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<sup>44</sup> Chapter 3 will examine the fiscal reforms and their impacts in more detail.

<sup>45</sup> For a detailed study of how township governments become “hollow shells”, see Smith (2010).

<sup>46</sup> In addition, village cadres are not state officials and therefore not part of the nomenklatura system. Legally, they are representatives of villages that aim at governing their villages. Village committees are served as the organizational unit and perform certain governmental functions.

entrepreneurial and developmental are strongly oriented toward the goal of increasing economic output and productivity. However, an entrepreneurial state denotes a direct involvement in economic activities, and has vested individual economic interests in particular enterprises and clients. Developmental state has indirect intervention in the economic growth but is more concerned with public socioeconomic interests (p.345-6). Indeed, unlike the entrepreneurial state of Guanghan County that seeks opportunities for personal self-gain or for departmental expansion described by Blecher and Shue (1996), local officials in Fugu County become economic players, directly engaging in economic activities, such as reorganizing the private coal-endowed industrial cluster, creating new enterprises, and designating officials to manage enterprises. In this sense, it is argued the local cadres, acting as entrepreneurs, strategically intervene in the private sector to ensure smooth economic growth and thus facilitate effective social development through the implementation of a set of rural development programs.

#### **2.5.4 Local Developmental State-Business Relations**

Concerning the relationship between local developmental state and the business sector, Oi (1999) illustrates the best case of the “local corporatist state” to highlight that the relationship between the two actors has not been a zero-sum game during the reform eras. Indeed, mutual dependence rather than predation is a more apt description of the relationship. This explains why large extractions of revenue have not negatively affected economic growth. However, the subtle changes between the periods of collective economy and private economy are noteworthy. Regardless of whether a collective or private economy, a contracting system has come into the play that connects the local governments and enterprises as mutually dependent on each other. During the 1980s, a revenue-sharing system granted local governments the right to the fiscal surplus from collectively owned enterprises as a form of profit-taking to pay for collective expenditures and reinvestment (Oi, 1999; p.97-98).

Since the 1990s, the effects of privatization either spurred by local state intervention or by outright state-sponsored privatization of formerly collectively owned enterprises have incorporated private entrepreneurs into the public sector-both state and collectively owned enterprises. Furthermore, it has created two important implications for the relationship between the local state and private enterprises. First, the state and the collective sectors have become significant sources of wealth for the private sector. Second, the growing private entrepreneurs are unlikely to be capable of usurping the power of local officials. On the contrary, the relationship between the local state and the private sector has become increasingly mutually dependent and symbiotic through the provision of production contracts by large state and collective factories to rural private enterprises. Rural private entrepreneurs have become part of, and in some cases reliant upon, the state and collective sectors in order to reduce risks while pursuing their economic interests. The relationship between the local state and the private sector is no longer likely to be adversarial. In addition, the importance of established personal connections with the public sector is also seen in the market behavior of private entrepreneurs. Just like those in the state sector, private entrepreneurs try to minimize risks, reduce transaction costs and engage in relationships with the public sector that offer profitable business opportunities (Oi, 1999, p.134-137). In return, the private sector plays a prominent role in generating tax revenues for the local state to pay for the public services devolved from the upper authorities. Thus, the symbiotic nature of the relationship between the local state and the private sector has kept predatory behavior, if found, to a minimum (Oi, 1999, p.202).

#### **2.5.5 Central-Local Relations: Agency Problem**

As far as the relations between central and local states are concerned, the agency problem is the most prominent issue which has been extensively examined (Baum and Shevchenko, 1999; Huang, 1996; Oi, 1999; Shirk, 1995; Wang, 1995; Whiting, 2001; Wong, 1991; Yang, 1994). Theoretically speaking, the agency problem rests on

information asymmetries and conflicts of interests contained in the incentive structure which is created by information asymmetries. First, the inevitable asymmetrical knowledge allows agents to always have an advantage over the principal in their knowledge of the true level of implementation and operation performance. Second, as a consequence, the inevitable information asymmetries create adverse selection, moral hazard and incentive problems, “among which, moral hazard and adverse selection are general problems whose potential is inherent in all contracting and hierarchical relationships” (Moe, 1984, p.755). Once moral hazard is involved, the agents are likely to use that knowledge to serve their own rather than the principal’s interests. Therefore, to mitigate the asymmetry or its consequences, it is necessary and rational for the principal to devise sufficient incentives that induce the agents to reveal as much of their privately held information as possible and fulfill the principal’s interests. “Hierarchical control is facilitated by a number of interrelated mechanisms, among the most important of which is the ‘residual’. The more general principal-agent models of hierarchical control have shown that, under a range of conditions, the principal’s optimal incentive structure for the agent is one in which the latter receives some share of the residual in payment for his efforts, thus giving him a direct stake in the outcome” (Moe, 1984, pp.762-763). Monitoring devices can be used as the second institutional arrangement by the principal to oversee and regulate the agents’ behavior and performance. However, the process is costly and less effective if the agents collude with partners to deceive the principal. Finally, it is necessary to bear in mind that (a) except for the ultimate principal and the ultimate agent, each actor in the hierarchy assumes a dual role in which he serves both as principal and as agent (Moe, 1984, p.766); and (b) a complicating but quite essential fact of politics emerges: political control is undermined by multiple-principal/agent arrangements. To put it differently, “any given bureau is likely to have multiple principals [and] bureaus are ‘partial agents’ of various governmental principals, without being under the complete authority of any one in particular, and without any common understanding of how authority is legitimately divided among the competing principals. [Likewise,] [...] each principal has various bureaus to oversee, but this complication may not be of great significance, since principals in fact have their own specialized hierarchies for



monitoring each bureau and, in many cases, no coordination is even desired” (Moe, 1984, p. 768-769).

The Chinese case illustrates that fiscal reforms are the most important mechanism to facilitate hierarchic control between the central state (principal) and local governments (agents) (Baum and Shevchenko, 1999; Huang, 1996; Oi, 1999; Wang, 1995; Whiting, 2001; Wong, 1991; Yang, 1994). The prevalent view is that fiscal and administrative decentralization in the 1980s granted provincial and sub-provincial governments broad discretionary authority to raise and allocate resources and revenues, but major concerns remain over how the decentralization reforms affected the power of the central state and reshaped the central-local relations. For instance, one suggestion is that the decentralization and deregulation reforms have so tilted the balance of fiscal and administrative powers and facilitated the growth of extrabudgetary funds in favor of the provinces, thus contributing to the decline of central state capacity to effectively control over China’s economic activities (Wang, 1995). Nevertheless, one claim is that decentralization has neither diminished the central government’s extractive capacity measured by the ratio of central government revenues to Gross National Product (GNP) nor undermined China’s unitary political system evaluated by the degree of central control over key provincial appointments (Huang, 1996; Yang, 1994). The third argument holds that “central leaders have not so much ‘lost’ control as they have chosen not to exercise it because provincial officials are a powerful bloc in the process of selecting top Communist Party leaders” (Shirk, 1995, as cited in Baum and Shevchenko, 1999, p. 335).

Wong (1991) focuses on three types of strategies that local governments used to respond to the constraints and incentives contained in the revenue-sharing fiscal system prior to the 1994 tax division system and their implications for the reform. Specifically, first, local governments passively negotiate with higher levels in the fiscal hierarchy for an adjustment in the division of revenues and responsibilities, in the hope of obtaining a more favorable revenue-sharing ratio, a bigger subsidy from the higher level, or a reduction in expenditure responsibilities. Second, local

governments actively promote the expansion of the local tax base by supporting local economic growth through direct investments. Third, local governments reach outside the budget process to tap extrabudgetary funds to finance government expenditures (p.707-708). She points out that the second and third responses run directly counter to efforts at reform because local government control of enterprise funds outside the formal system of taxation obviously violates the spirit of enterprise reform, which is aimed at increasing enterprise autonomy and insulating their operations from government interference. The second strategy of promoting local industrial growth is even more problematic, because of distorted prices and an unreformed tax structure. As a consequence, it is argued that local strategies of development have affected structural reform. First, they all adversely affect allocative efficiency. Second, the rise of regional protectionism has hindered the development of a national market and shielded enterprises from competition. Finally, tax-evasion and avoidance behavior defeats the original intention of fiscal decentralization: that of revenue mobilization and improving local collection efforts (p.709-710).

Beyond the provincial and municipality level, Oi (1999) and Whiting (2001) extend the analysis of central-local relations down to county and township governments by examining the behavior of local tax, finance and audit bureau cadres, and provide similar findings showing that local officials try to retain the tax revenues to swell their coffers. They both claim that the agency problem stems from the conflicting interests of principals and agents and from the information asymmetry which is intensified by the dual role and multiple-principal arrangements. Among these, Whiting (2001) argues that township officials are both principals and agents in the process of revenue extraction. They are principals with respect to the extraction of revenue for local coffers and agents of the central government in a nested hierarchy of subnational governments with respect to extraction of revenue for central coffers. The monitoring system clearly comes into play in the agency relationship. Where monitoring is lax, local officials succeed in diverting more revenue (particularly revenue from collective firms) from centrally controlled to locally controlled channels. Apart from this, the existence of collective organizational structures at the township level hinders the

mobilization of revenue from collective enterprises into channels controlled by the central state. As a consequence, all township officials have incentives to try to retain as much revenue as possible at the township level (p.25-8).

Again, Oi (1999) uses “local state corporatism” to examine the multiple-principal arrangements contained in the agency relationship. There are many different principals and agents at the county level and below. The interests of the local regulatory agents are only partially tied to the principal mandating the investigations - that is, the central state. Their positions are dependent on the goodwill of the central state through the nomenklatura system, but their salaries and general economic well-being depend on those whom they are investigating within the county. For tax, finance, and audit bureau officials, the principals who count are the county leaders: the Party secretary and the county mayor. Hence, when conflicting interests are involved, county and township regulatory officials choose to fulfill their immediate principal’s interests rather than the central state (p.153). Furthermore, she points out that the fiscal reforms have induced a separate set of incentives that leads local officials to provide minimum rather than maximum levels of compliance primarily in the assessment and collection of national taxes - that affects local economic growth and the revenues generated at the local levels. The emergence of local state corporatism has intensified the moral hazard problem in central-local relations by encouraging local officials to try to first protect the locality and only second the center when implementing central tax laws (p.159-60).

## **2.6 Strategic Group Approach and Strategic Group Analysis**

Strategic group approach was firstly formulated and refined by Hans-Dieter Evers (1966; 1973) and his colleagues at the Bielefeld School of Developmental Sociology. Based on large empirical examinations of social changes in Southeast Asia, the developmental sociologists developed this approach as a device to understand social actions and processes in fast developing countries, by reducing complexity. The

strategic group approach is an approach based on rational choice because it assumes that human actions are governed primarily by an interest in maximizing material and immaterial gains and profits and, secondarily, by motives such as love and hate, envy and admiration (Evers and Gerke, 2009, p.1). A strategic group is a quasi-group which possesses group or network characteristics. The members are not necessarily members of a network or members of an organization, but are united by one common interest: to secure present and future chances to gain access to resources; to share chances of appropriating resources and their distribution. Unlike individuals that may act for immediate gain, strategic groups follow long-term strategies and aim to create social, political and economic structures and institutions that enhance the chance to appropriate resources (Evers and Gerke, 2009, p.2).

As group conflict is inherent in a society structured by strategic groups, how can a strategic group be kept coherent? “Common values, ideologies and common interests are powerful binding forces and help to develop real groups out of quasi-groups. Strategic groups typically transcend social boundaries and encompass leaders and followers. They may cross class boundaries and its members may belong to different social strata. Kinship networks could also be a binding force of strategic groups” (Evers and Gerke, 2009, p.5). In this sense, strategic groups are fluid, but may be powerful and long lasting. The feature of fluidity is also manifest in the tendency for strategic groups to seek effective alliances to secure or enhance their chances of resource surplus. Nevertheless, this enhanced chance of appropriation does not mean that it is a zero-sum game by reducing the absolute income of other strategic groups or the population in general (economic growth with increasing inequality) (Evers and Gerke, 2009, p.7).

Strategic group analysis is used as a tool to examine the shift of power structure in a given social/geographic setting, specifically at different power groups which are competing for different resources. This analytic framework typically helps us to understand the group member’s behavior, interactions and the process of strategic group formation and strategies development when new resources become available.

Building on the strategic group approach, Bourdieu's theory of capital formation and the garbage can model from organization theory, Thomas Heberer and Gunter Schubert (2012) further extend the strategic group analysis to China's local states, conceptualizing county and township cadres as a strategic group and substantiating how the local cadres use their strategic agency to carry out effective policy implementation.

Strategic group denotes a group of actors who develop strategies for securing or pushing through group-related common interests. Berner (2005) underlines that strategic groups are not "actual groups in the sense that each member has contact with all others" and "are not a factual, observable object of research but rather an instrument of analysis" (as cited in Heberer and Schubert, 2012, p.225). The denotation reinforces the characteristics of a strategic group as an informal and open group that has shared interests which the members pursue strategically; operates through formal organizations; maintains mutual awareness and a collective identity through drawing boundaries to incorporate other social constituencies; and possesses a common life-style patterns (Bourdieu's *habitus*) related to the similar positions of its members in a given social field (Heberer and Schubert, 2012, p.226). Based on the above factors: common interests, close positions in the political system, similar social status and life-style patterns and a powerful organizational structure (eg. the local branch of the Communist Party), the internal coherence of leading county and township cadres as a strategic group is enhanced greatly in the process of local decision-making and policy implementation. Positional closeness in the political system exposes the local cadres in the strategic group to pressure from both higher-level authorities and the rural populace and forces the group core leaders and all other members into strategic alliance and cooperation. Only in this way can the strategic group members maximize their benefits. As a result, county and township cadres form "a symbiotic relationship of mutual dependence" (Heberer and Schubert, 2012, p.228).

Why are village cadres, or cadres from prefectural and provincial levels above,

excluded from becoming the members of a strategic group? First, village cadres are not state officials and hence not part of the personnel system. They generally enjoy very little autonomy from township authorities. Even though the introduction of village elections since the late 1980s has created more deliberation and negotiation between the township and village cadres, the differences between them in terms of power and status perception are still significant. It is unlikely that they would form an alliance against the county government. On top of that, township cadres depend on the county government for the appropriation of funds to pay salaries and administrative expenditures, as well as career promotions. Second, provincial and city-level (prefectural) authorities exercise control over the county government through delegation, monitoring and evaluation systems, therefore county government has relative discretion to carry out development plans in accordance with local circumstances. The county-wide project implementation and evaluation further reinforces the collective identity and interests of county and township cadres. Finally, the common interests and identity of leading county and township cadres is usually limited to the jurisdiction where they work (Heberer and Schubert, 2012, p.229-232).

County and township cadres do not by any means form a homogeneous group. In fact, they compete for career promotion, factional affiliation, bureaucratic power and status in the hierarchical system. However, they form a strategic group that encompass officials ranking from vice-bureau head (*fukeji*) upwards at county level led by a core group (*lingdao banzi*) that is topped by the county Party secretary, who makes all the final decisions. As the “paramount leader” of the strategic group and its core role, the county Party secretary in fact acts as a political entrepreneur in the sense that he, on the one hand, has to be responsible for the formulation of local development; on the other hand, he has to ensure group unity and the compliance of all members to follow the leading core’s decision. In this sense, Bourdieu’s economic, cultural, social, symbolic capitals and newly introduced structural capital as formal and informal institutions contribute to establishing the shared identity and group cohesion. For instance, the Party branch and Party school and official meetings are seen as formal institutions, reputation, prestige, personal relationships (*guanxi*) and networks as

informal institutions (Heberer and Schubert, 2012, p.232-238).

To explain the diverging patterns of strategic agency within the strategic group, Heberer and Schubert (2012) suggest that extrinsic and intrinsic incentive structures play a crucial role in the process of policy implementation by the group members. The extrinsic incentives include material and immaterial items (such as remuneration and bonuses, promotion prospects and demotion threats). The intrinsic incentives refer to value orientations, personal background and past experiences, etc. However, the incentive structures are insufficient to account for the diverging patterns and policy outcomes in rural China. “Organized anarchy”, therefore, is introduced as a concept to explain the variation in local policy processes. “Organized anarchy” is attributed to institutional uncertainty and ambiguity, where multiple choices are available for solving a problem. When local cadres implement the ambitious rural development projects or solve the “big problems” (social welfare, education, infrastructure, sanitation) devolved from upper authorities, they have relative autonomy to formulate the details of project implementation and therefore, the project outcomes remain subject to their interpretations and preferences of the deliberately obscured central policy (Heberer and Schubert, 2012, p.239-244).

Following Heberer and Schubert (2012), this study will use strategic group analysis as an approach to examine local cadres’ behavior in Fugu County, specifically how county and township cadres form a strategic group and co-opt local coal mine owners into the strategic group in order to successfully implement the rural development program formulated by the central government. As a result, local coal mine owners become part of the strategic group formed by local cadres. The alliance is effectively formed based on the symbiotic relationship between the local state and private sector.

## **2.7 Summary**

This chapter has reviewed a broad variety of approaches to the developmental state,

including the definitions, notions, and relations among the developmental state, society and business and the political and economic conditional effects. Based on theoretical explorations of these issues, I have summarized four defining features of the developmental state: development-oriented political leadership, an autonomous and effective bureaucracy, a production-oriented private sector and performance-oriented governance. Furthermore, this chapter has examined the application of four defining features in China and developed Local State Entrepreneurial-Developmentalism to analyze the local officials' behavior presented in Chapter 4. I have additionally discussed the consequences of local the developmental state with regard to state-business relations and central-local relations respectively, and the strategic group approach.



## Chapter 3. Fiscal Reform and Cadre Evaluation System as Incentives

### 3.1 Preamble

This chapter reviews the evolution of local non-agricultural economic organization in Chinese counties and their subordinated jurisdictions from the beginning of the reforms till the emergence of the county as an “entrepreneurial-developmental state.” The core elements of institutional evolution from the late 1970s till the 1990s are, I claim, contained in two policies, one relating to *fiscal and public finance reform* and the other to *cadre evaluation*. These policies combined to create powerful incentives for local cadres to achieve economic growth, and gave direction to their efforts. The core resources the local officials could access were the revenues of non-agricultural enterprises, in the case of Fugu County, mainly enterprises in coal-related sectors. In essence, the evolving fiscal and public finance regimes accordingly forced local officials to extract budgetary revenues (i.e. “matching funds”) from locally-owned enterprises to finance social welfare and rural development programs devolved from central and/or upstream authorities (Xu and Xie, 2009; He, 2006). The cadre evaluation system with its emphasis on maintaining a peaceful social order gave local cadres a strong incentive to increase revenues to compensate disadvantaged villagers through evolving redistribution mechanisms.

In order to contextualize this process, the first section of this chapter briefly outlines the institutional prerequisites for the rise of the local “entrepreneurial-developmental state” (based on the “county-wide economy”) and the fiscal/financial and cadre evaluation regimes it involved. In the subsequent sections, the evolution of fiscal/financial and cadre evaluation practices since the beginning of the reforms are sketched out. In the next chapter, the evolution of rural industry as a basis for the formation of the local “entrepreneurial-developmental state” in Fugu is analyzed.

### 3.2 Institutional Constraints of CNSC Implementation

Like most rural social policy implementation, CNSC follows the fiscal system of “money passed down by the central government through the fiscal system, either as general transfer payments (*yibanxing zhuanyi zhifu*) or as earmarked funds (*zhuanxiang zijin*)” (Schubert and Ahlers, 2012, p.73).<sup>47</sup> According to the rules, local administrative hierarchies from province to county are all involved in the practice of raising matching funds for national rural development programs. Some programs explicitly state in their documentation the portion of matching funds to be provided by local governments, while other programs grant local governments discretion over the proportion of matching funds. For example, the Measures on the Management of the State Budgetary Poverty Relief Funds issued in 2000 explicitly announced that local governments must provide no less than 30% of matching funds. If provinces, autonomous regions and municipalities<sup>48</sup> fail to meet the matching funds imperative set by the center, they might face economic punishment like a reduction in next year's budget allocation, as well as political punishment in the form of administrative sanctions against the cadres directly in charge.<sup>49</sup> The proportion of matching funds

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<sup>47</sup> According to Schubert and Ahlers (2012, p. 73), “[t]ransfer payments can be used by county governments at their own discretion, whereas earmarked funds must be allocated according to pre-determined purposes.”

<sup>48</sup> There are currently four municipalities in China, namely Beijing, Shanghai, Tianjin and Chongqing. Their administrative status is similar to that of a province, dealing directly with the central government; they govern the counties within their jurisdictions directly without any prefecture-level authorities involved. The five autonomous regions (of national minorities) are also at the provincial level of administrative status. In addition, a small number of large cities and special economic zones are “direct planning cities” (*jihua danlie shi*) which for the purpose of planning, budget and tax administration are handled separately from the provinces in which they are situated.

<sup>49</sup> The policy was issued jointly by Ministry of Finance, Leading Group of the State Council for Development-Oriented Poverty Relief and former State Planning Commission. For details, see *Guanyu yinfa caizheng fupin zijin guanli banfa (shixing) he caizheng fupin xiangmu guanlifei guanli banfa (shixing)de tongzhi* (Circulars Concerning the Experimental Measures of Fiscal Funds for Poverty Alleviation and Project Management Fees). Website of Ministry of Finance. [http://www.mof.gov.cn/zhengwuxinxi/caizhengwengao/caizhengbuwengao2000/caizhengbuwengao2004/200805/t20080519\\_21529.html](http://www.mof.gov.cn/zhengwuxinxi/caizhengwengao/caizhengbuwengao2000/caizhengbuwengao2004/200805/t20080519_21529.html) (accessed 5 October 2015).

required by local governments for centrally assigned earmarked funds varies regionally. As a general rule, provincial governments enjoy full discretion to determine the proportion of matching funds that prefectural city and county governments must raise in order to receive program fund allocations. The matching funds required from wealthy counties tend to be larger than those to be raised from poor or underdeveloped localities; this is often referred to as a “meal ticket” (*chifan caizheng*). For instance, Shaanxi Provincial Government stipulated that the top 20 counties in terms of fiscal revenue per capita must provide 50% of matching funds for financing under CNSC.<sup>50</sup> Fugu County has fallen into the top 20 counties list since 2007.<sup>51</sup>

The centrally assigned tax refunds (*shuishou fanhuan*) and transfer payments (including general transfer payments and earmarked funds)<sup>52</sup> bound by the tax division system (*fenshuizhi*) in late 1993 fall into the local governments' budgetary revenue, and the matching funds provided by local governments are similarly extracted from their budgetary revenue as well.<sup>53</sup> On the one hand, the tax division

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<sup>50</sup> See *Shaanxisheng guanyu cujin pinkun diqu shehui zhuyi xinnongcun jianshe de yijian* (Opinions Concerning Shaanxi Province Promotes CNSC in Underdeveloped Areas). Website of the Communist Party of China. <http://cpc.people.com.cn/GB/64093/67507/5597596.html> (accessed 5 October 2015).

<sup>51</sup> Fugu County ranked 35<sup>th</sup> of Shaanxi Province County Economy Comprehensive Assessment in 2005, 23<sup>rd</sup> in 2006, 5<sup>th</sup> in 2007 and 3<sup>rd</sup> in 2008. See *Shanxi fugu tuidong xianyu jingji shixian kuayue fazhan* (From Being Middle Reaches to Pacesetter: Fugu County Achieved Sound and Rapid Development of County-Wide Economy). Website of Shaanxi Daily. [http://www.sxdaily.com.cn/data/jjxsd/20090707\\_9905600\\_0.htm](http://www.sxdaily.com.cn/data/jjxsd/20090707_9905600_0.htm) (accessed 5 October 2015).

<sup>52</sup> See *Shuishou fanhuan he zhuan yi zhifu zhidu* (Tax Refund and Transfer Payments Systems). Website of Ministry of Finance of PRC. [http://www.mof.gov.cn/zhuantihuigu/czjbqk2010/2cztz/201110/t20111031\\_603357.html](http://www.mof.gov.cn/zhuantihuigu/czjbqk2010/2cztz/201110/t20111031_603357.html) (accessed 5 October 2015).

<sup>53</sup> Financial income is officially divided into three types, budgetary revenue (*yusuannei shouru*), extra-budgetary revenue (*yusuanwai shouru*), and contributionary revenue (*zhiduwai shouru*). As a rule, budgetary revenues account for 50% of the government's total revenue, extra-budgetary and contributionary revenues each account for about 25% (Wang and Zhao, 2006, p. 83). For specific classification and evolution of China's financial management spanning the years 1950-94, see Oi (1999, Appendix B, p. 213-216). For the full text of the Budget Law of the People's Republic of China enacted on January 1, 1995, see *Zhonghua renmin gongheguo yusuan fa* (Budget Law of the People's Republic of China). Website of National People's Congress. [http://www.npc.gov.cn/wxzl/gongbao/2000-12/05/content\\_5004614.htm](http://www.npc.gov.cn/wxzl/gongbao/2000-12/05/content_5004614.htm) (accessed 5 October 2015).

system divided the tax revenue into three categories: central, local, and central-local shared taxes. It fundamentally reduced local governments' budgetary revenues (Whiting, 2001). On the other hand, the tax-and-fee reform (*shuifei gaige*)<sup>54</sup> from the early 2000s abolished the agricultural taxes and eased the "farmers' burden" (*nongmin fudan*) by decreasing the annual taxes and fees paid by farmers by more than RMB 100 billion, compared to 1999.<sup>55</sup> A derived effect was that it further eroded local tax revenues in particular in localities that primarily relied on agriculture (Kennedy, 2007; Wang and Zhao, 2006; Zhu, 2002). The tax-and-fee reform thus caused local governments, in particular the township governments, to face even greater fiscal constraints when raising matching funds (mainly to be extracted from local tax revenue) for CNSC.

I argue that incentives and constraints contained in the institutional arrangements of the fiscal reform in the 1990s and the tax-and-fee reform in the 2000s, associated with the cadre evaluation system fundamentally affected local officials' behavior. They were driven by political as well as economic incentives to boost rural industry in order to generate revenue for local government coffers, finance the provision of public goods and social welfare, and create jobs. In the case of Fugu, the pressures felt in terms of funding CNSC were an example of this. First, the revenue-sharing fiscal system has created a revenue imperative for local officials by requiring that local governments to extract matching funds from budgetary revenues (mostly tax revenues). However, most counties in China are faced with extracting matching funds from

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<sup>54</sup> The tax-and-fee reform, initiated by the central government, eliminated all non-tax local fees as well as animal slaughter tax, agriculture-animal husbandry tax and special agricultural product other than tobacco tax. See *Guojia shuiwuju: mianzheng nongyeshui huiji 8 yi zhongguo nongmin* (State Administration of Taxation: Abolishing Agricultural Taxes Benefits 0.8 Billion Farmers). Website of People. <http://politics.people.com.cn/GB/1027/4069907.html> (accessed 5 October 2015).

<sup>55</sup> Jin Renqing, the former Minister of Finance (2003-2007) claimed that 0.8 billion farmers in China would be gaining benefits from the abolition of agricultural taxes in 2006. See *Dali zhichi shehui zhuyi xinnongcun jianshe* (Greatly Support CNSC). Website of Ministry of Finance. [http://www.mof.gov.cn/zhuantihuigu/2006ysbgjd/bjzl/200805/t20080519\\_23243.html](http://www.mof.gov.cn/zhuantihuigu/2006ysbgjd/bjzl/200805/t20080519_23243.html) (accessed 5 October 2015).

budgetary revenues. As the Deputy Director of Research Institute for Fiscal Science, Ministry of Finance claimed:

It is estimated that 80% of counties are poor, because the personnel cost already accounts for 60%-80% of budgetary revenues, coupled with administrative expenses, there is little left for matching funds at county level.<sup>56</sup>

Furthermore, county governments are required by the central government to provide public goods and social welfare, which are called hard expenditure targets (*fading zhichu*, including spending on education, science and technology, agriculture, culture and health care).<sup>57</sup> The hard expenditure accounts for a lion's share of local government's budgetary spending. For instance, the 2010 Audit Results showed that *fading zhichu* of 54 counties accounted for 77.23% of total public fiscal expenditure.<sup>58</sup> As a consequence, local governments are left with very limited leeway and autonomy to harness the budgetary revenues, and some are even likely to fall into a deficit. In order to fulfill the tasks devolved from upper authorities, local governments must channel certain portion of extra budgetary incomes into the budgetary revenues.<sup>59</sup> Indeed, this fully explains why Fugu County is still faced with the strong constraint of matching funds extracted from budgetary revenues though it has generated fiscal

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<sup>56</sup> See *Ruguo peitao zijin meigenshang* (If Matching Funds Are Not Kept Up). Website of Observation in Economics. <http://www.eeo.com.cn/2013/0331/242044.shtml> (accessed 5 October 2015).

<sup>57</sup> Since the 8<sup>th</sup> Five Year Plan was implemented in 1991, central and local governments have set up a specific portion of expenditure on education, science and technology, agriculture, culture and health care. In addition, the central government promulgated that the growth rate of government spending must be higher than the growth rate of budgetary revenues. See *Jiaoyu keji nongye deng caizheng zhichu buzai niannian zeng* (The Public Fiscal Expenditure Will Not Grow Every Year). Website of Caixin. <http://m.economy.caixin.com/m/2013-11-17/100605835.html> (accessed 5 October 2015).

<sup>58</sup> See *2012 nian di 26 hao gonggao: 54 ge xian caizhengxing zijin shenji diaocha jieguo* (2012 No. 26 Announcement: The Audit Results of 54 Counties' Financial Funds). Website of National Audit Office of PRC. <http://www.audit.gov.cn/n1992130/n1992150/n1992500/3043614.html> (accessed 5 October 2015).

<sup>59</sup> See *Yusuanwai shouru difang zhengfu yunxing bukehuaqu* (Extra-Budgetary Revenues: Indispensable for Local Governments Function). Website of Sina. <http://finance.sina.com.cn/review/20070330/02413455437.shtml> (accessed 5 October 2015).

revenues efficiently by virtue of the coal-endowed private sector. Finally, local governments are unlikely to provide matching funds because they intend to develop their own characteristic industry (*teshe chanye*). Indeed, it is rational and ideal for local governments to receive the transfer payments from upper authorities but keep their budgetary revenues untouched.<sup>60</sup>

Against this background, raising matching funds from outside the budgetary revenues has become another prerequisite for CNSC implementation. In fact, the center has expected and encouraged localities to support CNSC with profits from rural industry, under the schemes for “using industry to promote agriculture” (*yigong cunong*) and “using urban areas to promote rural areas” (*yicheng daixiang*).<sup>61</sup> The schemes have accordingly inspired local cadres to raise matching funds directly from the rural industry in a situation where Fugu County happened to have an ample endowment of coal resources that made this easy.<sup>62</sup> In sum, the powerful constraint of matching funds has created two methods for local governments: one is to extract from budgetary revenues by expanding the tax base, and increasing tax revenues; the other is to raise funds directly from the business sector.

Second, as argued in Chapter 1, the cadre evaluation system has powerfully shaped local cadre behavior by linking both their material gain in terms of remuneration and rewards, and immaterial goods in terms of their career advancement, social status, prestige, respect, and *mianzi* (lit. “face”: esteem, dignity, recognition) to performance

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<sup>60</sup> See *Ruguo peitao zijin meigenshang* (If Matching Funds Are Not Kept Up). Website of Observation in Economics. <http://www.eeo.com.cn/2013/0331/242044.shtml> (accessed 5 October 2015).

<sup>61</sup> For “using industry to subsidize agriculture” (*yigong bunong*), i.e. using TVE profits to support agriculture, see Study on China’s Policy Direction of TVE Industry Development (*Zhongguo xiangzhen gongye fazhan de zhengce daoxiang yanjiu*) pp. 125-127. For “using industry to promote agriculture” (*yigong cunong*), see *Guowuyuan fazhan yanjiu zhongxin nongcunbu buzhang tan xinnongcun jianshe zijin* (An Interview with Han Jun, the Director of Research Department of Development Research Center of the State Council Concerning CNSC Funds). Website of Chinese government. [http://www.gov.cn/zwhd/2006-02/27/content\\_211797.htm](http://www.gov.cn/zwhd/2006-02/27/content_211797.htm) (accessed 5 October 2015).

<sup>62</sup> In the local context, self-collected funds by local governments are also put in the broader category of matching funds.

in economic as well as sociopolitical dimensions (Feng, 2013; Heberer and Trappel, 2013; Landry, 2008; Yang, 2004; Zhou, 2008). Economic dimensions centered on the promotion of industrial development, while sociopolitical dimensions mandated the financing and provision of public goods devolved from center to local governments and maintaining social stability (*weiwén*) thus have reinforced the revenue imperative facing local leaders.

In order to fully explain why the fiscal revenue system and cadre evolution system after 2006 created such an impetus for local officials to extract and raise matching funds for CNSC implementation from rural enterprises in this way, it is necessary to trace the relationship between local government and local enterprises back to the situation under the people's commune system before the reforms commenced in 1978. The historical legacy of state policy towards enterprises played an important role in shaping the behavior of local officials in Fugu County.

### **3.3 Rural Industrialization as a Source of Local Public Finance**

The intense debates on rural industrialization during the Maoist period had as a main focal point the fact that the “command economy” dominated by the state plan and the fiscal system provided localities with little incentive to increase revenues (Oi, 1995, 1999; Whiting, 2001). “[L]ocalities were required to turn over all or most of their revenues to the upper levels, which in return provided budget allocations for expenditures. The use of whatever surplus that remained within the locality was subject to higher-level approval. Rather than initiate growth, localities had incentives to try to extract as much bureaucratic slack as possible from the upper levels in the form of larger budget allocations” (Oi, 1999, p. 6). Yet, as Whiting (2001, p.40) observes, “[t]he legacy of rural industrial development during the Maoist period has had profound implications for the subsequent development of rural industry during the reform period.” This dissertation agrees that the commune and brigade enterprise (CBE) legacy had such implications, and focuses on one significant aspect of rural

industrial development, namely their function in local fiscal and public finance practices during the reforms. Faced with the imperative of self-financing in the early 1980s, local cadres suddenly had strong incentives to promote local industrial development. The cadre evaluation system, officially introduced in 1979, shaped local officials' behavior as they sought to maintain and reinforce their positions of power. They did this by securing social stability and the provision of public goods based on mandated financing. From the start of the reforms and well into the 1980s the central government encouraged China's coal mining industry to shed its total domination by the state sector and mandatory state planning and to diversify in terms of ownership structure and responsiveness to the market (Wang, 2006). After the revenue-sharing system had been put in place in 1980, local officials in Fugu began to rely on the extracting budgetary and extra-budgetary revenues from the large local endowment of coal resources. In the following I shall outline how local cadres in Fugu responded to the incentives to generate coal-led tax revenue for local political purposes and eventually the policy at the center of the study-CNSC.

### **3.3.1 Fiscal Incentives for Rural Industrialization**

As explained in Chapters 1 and 3, the changes in the fiscal system and the cadre evaluation systems reshaped, in particular at the township level, the "property rights" to government revenues and also created a strong incentive for township officials to pursue rapid rural industrialization; these were, in fact, two sides of the same issue. Oi (1999, p. 27) points out how the fiscal reforms in the 1980s granted county and township governments new rights to appropriate revenues and dispose of, manage, and collect incomes and surpluses from them in ways that resembled the role of *owners* rather than that of public servants.

The main reason for this was that central/upper-level government no longer made budgetary funds available to meet local expenditures. As Oi (1999, p. 28) notes, "[C]hina converted a vertical (*tiao*) apportionment system that had allocated revenues



from the upper to the lower levels into a system in which localities had to rely primarily on horizontal flows (*kuai*)- that is ,on income that they generated themselves.” To put it differently, local governments from the 1980s were forced to generate financial income themselves (self-financing). The fiscal reforms of the 1980s also granted local governments control over (local) surpluses, in particular enterprise profits. This reassignment of property rights provided local authorities with a positive inducement to promote rapid economic growth in order to generate additional revenues.

The revenue-sharing system, also referred to as the “fiscal contract system” (*caizheng baogan*) and metaphorically referred to as “eating at separate stoves” (*fenzao chifan*), required local governments down to the level of the township to collect all national taxes and then turn over a portion of this revenue to the next higher level (Oi, 1999; Whiting, 2001; Wong, 1999). In general, the more a locality collected, the more it could retain. The portion of revenue sharing was formalized in fiscal contracts between the administrative hierarchies from central to townships in accordance with local revenue situations. The terms of the contracts varied. For instance, Yulin Prefecture, as the next higher level of Fugu County, together with another five poor prefectures, retained their fixed revenues and industrial-commercial taxes, and if the income was less than expenditure, Shaanxi Province provided fixed subsidies to compensate for the shortfalls.<sup>63</sup>

Historically, Fugu County had enjoyed a “meal ticket” financial status for a rather long period due to its geographical location and poor agricultural harvest. The financial

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<sup>63</sup> See *Shaanxisheng renmin zhengfu guanyu shixing huafen shouzhi, fenji baogan caizheng guanli tizhi de tongzhi* (Circular Regarding “Divide Revenue and Expenditure, Contract by Different Administrative Levels” Issued by Shaanxi Provincial People’s Government). Website of Legislative Affairs Office of the State Council, PRC. <http://fgk.chinalaw.gov.cn/article/dfgz/198004/19800400290457.shtml#> (accessed 5 October 2015). Based on the financial income and expenditure plan of 1979, the locality prescribed a ratio to determine how much of a locality's income and other revenues was to be retained in 1980. Oi (1999, p. 31) further explains, “[w]hen the local set revenue and the central-local shared revenue together are not sufficient to cover expenses, the center will give a fixed subsidy to the locality. Once this is established, it will not change for five years.”

income generated by Fugu County barely sufficed to cover essential expenditures (i.e. administration, education and health care), not to mention the investment in economic growth. Instead, it relied heavily on fixed subsidies from upper levels, which accounted for 69% of the total budgetary revenues between 1978 and 1989 (Table 3.1). As a listed poor county, it had since 1949 received large subsidies from upper levels. Specifically, it received a fixed subsidy of RMB 3.44 million per year spanning the years 1980-85.<sup>64</sup>

The 1985 fiscal contracts turned Shaanxi Province into a net subsidized locale because it had to remit 70% of product tax, value-added tax and business income tax extracted from central-government-owned enterprises to the center. As a result, Shaanxi Province received more than RMB 0.27 billion per year as fixed subsidy from the center and Fugu County received RMB 4.378 million per year from upper level spanning the years 1985-1990.<sup>65</sup> Oi (1999) relates that, in 1991, fourteen out of thirty-five listed provinces, autonomous regions, and municipalities, received fiscal transfers from the center. Thus the question of whether the localities that receive subsidies have an incentive to develop arises. Oi's (1999, p. 31) study indicates that "[w]hile local budget constraints are softened by the existence of subsidies, the pressure to increase revenue remains strong." Table 3.1 underpins this argument. Although statistics show that the subsidies accounted for 69% of the total budgetary revenues from 1978 to 1989, Fugu County pursued economic growth and increased income in particular when the "tax for profit" (*ligaishui*) reform was instituted in the mid-1980s to provide the state with revenue and to create an incentive for SOEs to become more efficient and profitable. In 1984, the SOEs in Fugu earned RMB 1.23 million in profits and contributed with RMB 0.81 million to the income tax, which accounts for 66% of profits. Table 3.1 also illustrates that local government relied primarily on the

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<sup>64</sup> See *Fugu xianzhi*, p. 441.

<sup>65</sup> For Shaanxi Province's fixed subsidies, see *Shaanxi Shengzhi*, p.757-758. For Fugu County's subsidies, see *Fugu xianzhi*, p. 441.

industrial-commercial tax, which accounts for 82% of the sub-total revenue generated in the locality and 26% of total revenue spanning the years 1978-89. In addition to the fixed subsidies, Fugu County, as one of the underdeveloped areas, was qualified to receive earmarked funds in order to facilitate the economic growth and lift the area out of poverty. Between 1978 and 1989, Fugu County received RMB 17.36 million as development funds and local officials invested 18.1% of the funds in industry, 2.4% of the funds in TVEs.<sup>66</sup>

**Table 3.1: Total Budgetary Revenues in Fugu County (RMB Million) (1978-89)**

Year	Enterprise Income Tax	Industrial & Commercial Tax	Agricultural Tax	Other Income	Sub-Total	Fiscal Transfers & Subsidies
1978	-1.155	1.148	0.131	0.058	0.182	9.221
1979	-0.212	1.183	0.138	0.002	1.111	5.140
1980	0.068	1.100	0.012	0.011	1.191	5.892
1981	-0.04	1.026	0.040	0.043	1.069	6.933
1982	0.151	1.132	0.109	0.078	1.470	5.941
1983	0.748	1.274	0.229	0.026	2.277	6.393
1984	0.199	1.471	0.219	0.095	1.984	8.086
1985	-0.937	3.119	0.206	0.071	2.459	7.929
1986	0.320	3.368	0.318	0.134	4.140	8.387
1987	0.569	4.817	0.305	0.168	5.859	8.916
1988	0.511	6.676	0.391	0.242	7.820	9.481
1989	3.435	8.002	0.470	0.250	12.157	9.762
Total	3.657	34.316	2.568	1.178	41.719	92.081

Note: In order to compare the subsidy with financial income, I have left out the balance of previous years that accounts for only a tiny percentage of the total annual budgetary revenues.

Source: Adapted from *Fugu xianzhi*, p.446.

However, as argued earlier, the subsidies are usually insufficient ways of paying expenses, especially in poor areas, where the subsidies are difficult to cover all essential expenditures. As shown in Tables 3.1 and 3.2, over a 12-year period, the subsidies received by Fugu government were always less than the budgetary expenditures, other than in 1978. The shortfalls had to be compensated by local governments themselves. In this sense, the pressure of self-financing system imposed

<sup>66</sup> See *Fugu xianzhi*, p. 449.

on local officials creates powerful incentives to increase revenues in order to maximize the surplus.

**Table 3.2: Total Budgetary Expenditures in Fugu County (RMB Million) (1978-89)**

Year	Econ. Development Investment	Educ. & Health Care	Admin. Expend.	Other Expend.	Remittance	Total Expend.
1978	5.497	1.807	0.944	0.112	0.493	8.853
1979	3.103	2.310	1.160	0.334	-	6.907
1980	2.162	2.227	1.253	1.451	0.005	7.098
1981	1.467	2.744	1.065	2.125	0.425	7.826
1982	1.653	2.645	1.391	1.486	0.014	7.189
1983	1.776	2.871	1.625	1.473	0.469	8.214
1984	1.930	3.125	2.136	2.496	0.502	10.189
1985	2.558	3.141	2.161	2.811	0.159	10.830
1986	2.188	4.332	2.705	3.173	0.193	12.591
1987	3.675	4.835	3.260	2.017	0.204	13.991
1988	4.726	5.494	3.129	3.972	0.239	17.560
1989	5.808	7.843	4.216	3.894	0.054	21.815
Total	36.543	43.374	25.045	25.344	2.757	133.063

Source: Adapted from *Fugu xianzhi*, p.447.

Officials at county level generate extra-budgetary revenues primarily from local taxes that are allowed by the center as belonging exclusively to the localities. Table 3.3 shows the categories of local taxes. In addition to the local taxes, county government swells its coffers with contributionary funds from the following sources:

- 1.income belonging to local finance and tax bureaus
- 2.income of functional and administrative departments not counted in budgetary funds
- 3.various funds from outside of the budgetary and extra-budgetary channels held by publicly owned enterprises and their leading organs<sup>67</sup>
- 4.profits transferred from locally and collectively owned enterprises
- 5.profit retention and management fees

**Table 3.3: Major Budgetary Taxes and Extra-Budgetary Revenues, Pre-1994**

<sup>67</sup> Publicly-owned enterprises refer to state-owned and collectively owned enterprises, in contrast to privately-owned enterprises and foreign and joint venture enterprises.

Budgetary Taxes	Extra-Budgetary Revenues	Contributory Revenues
Income Tax Industrial-Commercial & Circulation Taxes -Product Tax -Value-Added Tax -Turnover & Business Tax	Local Taxes -Agriculture & Animal Husbandry Tax -Special Agricultural & Forestry Products Tax -Property Tax -Land-Use Tax -Animal Sales Tax -Animal Slaughter Tax -Collective & Individual Enterprise Sales Tax -Collective & Private Enterprise Income Tax -Stamp Tax -Urban Maintenance & Construction Tax -Other	Non-tax Levies & Revenues -Contracted Profits -Management Fee -Ad Hoc Charges -Loans & Voluntary Contributions -Enterprise Retained Profits

Source: Adapted from Oi (1999), p.39. I put the non-tax levies and revenues under the category of contributory revenues.

Among them, the state-owned profit retention and contracted profits from enterprises grew enormously nationwide. As Oi (1999, p. 43) notes, “[n]ationwide, retained enterprise funds increased almost nineteenfold from 1978 to 1987.” In Fugu County, government agencies owned and oversaw the enterprises. For example, in 1989, the Economic Commission (*jingji weiyuanhui*) managed 10 enterprises in sectors ranging from coal mining to carpets, while the Light Industry Bureau (*qing gongyeju*) managed 13 enterprises. Due to the profit retention and tax-for-profit reform, these local state-owned enterprises increased the financial income of the county agencies. Other large contributory funds consisted of management fees and profits of companies set up by county agencies. As a rule, TVEs were required to pay management fees to the Rural Enterprise Management Office (*xiangzhen qiye guanli bangongshi*) established in the townships, the management fee was shared with the Rural Enterprise Management Bureau (*xiangzhen qiye guanliju*). Moreover, the companies set up by the county agencies were required to turn over after-tax profits to the agencies as well (Oi, 1999, p. 46).

At the township level, the main non-tax revenues stemmed from a share of gross income of all township-owned TVEs. As Christiansen and Zhang (1998, p. 6-7) note, “[e]nterprises owned by the towns and townships, however, were not normally privatized or made totally autonomous from the townships but were subordinated to

them in various contractual relationships. [...] These enterprises were obliged to pay a share of their profit to their owner (the town, township or administrative village) and taxes to the government.” Oi (1999, p. 46) further explains how the non-tax payments were made within a township government and its agency respectively. The township government received a fixed percentage of the profit of all township-owned enterprises before any taxes were extracted. Some townships exceeded the rate of 10 percent stipulated by the center. The township economic commission first levied a management fee on total sales, and the fee varied from region to region. Second, it collected a contract fee (“lease,” *chengbao fei*) from all township-owned enterprises. The contract fee paid by the contractor (i.e. factory manager) varied and made differently in contracts. “Similar arrangements were made for the enterprises owned by the administrative villages” (Christiansen and Zhang 1998, p. 6). Other sources of surplus transfers included “three extractions and five fees” (*san ti wu tong*).<sup>68</sup> However, the primary source of township contributionary revenues was collectively owned TVEs that paid various non-tax fees and *ad hoc* surcharges. For instance, township governments collected various fees from collectively owned TVEs under the rubric of “raising capital” (*jizi*), “voluntary contributions” (*juankuan*) and “unsanctioned levies” (*tanpai*) in order to provide public goods and services, and finance particular projects. The amount of fees and surcharges extracted from the collectively TVEs varied substantially by locality and from year to year.

In sum, the 1980s fiscal reforms enhanced the localities’ fiscal autonomy and granted the localities a right to the economic residual that created a powerful incentive for local officials to generate local residuals in order to grow extra-budgetary and contributionary funds. However, from the perspective of the central state, its share of total revenues diminished. As Whiting (2001, p. 279) points out, the “[b]udgetary revenue as a share of GDP declined steadily from the late 1970s through the mid-1990,

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<sup>68</sup> Three extractions and five fees were all collected from farmers and managed by township governments, including public reserve funds, public welfare funds, management fees, education surcharges, family planning fees, etc. They were abolished during the tax-and-fee reforms in the early 2000s.

while the center's share of budgetary revenue declined over much of the same period. [...] Indeed, budgetary revenue as a share of GDP fell from 34 percent in 1978 to 12.7 percent in 1994, while officially reported extra-budgetary revenue as a share of GDP climbed from 2.6 percent to 4 percent in 1994." To resolve the fiscal dilemma, the center introduced a tax division system to control extra-budgetary and contributionary funds by taking more in taxes from the localities in 1994 (see Appendix I). It reclassified categories of income and rearranged more revenue for revenue sharing and made a claim on profits retained by enterprises that was a key portion of contributionary revenues. Nevertheless, the 1994 fiscal reforms did not change the fiscal landscape dramatically, since many features of fiscal contracting remained, and at the local levels, the old contracts with the townships still continued to function (Oi, 1999, p.54). Without doubt, the 1994 tax division system resulted in a substantial increase in the amount that the localities had to pay to the center. More importantly, the 1994 reform, like its predecessors, granted the localities exclusive rights to extract a clearly defined surplus (profit). Appendix I shows that the sales tax, local enterprise income tax, profit turnover from local enterprises, personal income tax (*geren suode shui*), real estate tax (*fangchan shui*), animal slaughter tax, along with nontax revenues still belonged to the localities. From the perspective of local authorities, the 1994 system has had a significant impact on local finances. Oi (1999, p. 55) points out that, "[t]he obligation of localities to pay substantially more revenues to the center has caused massive problems for some of them, as they now face difficulties in paying for basic expenditures, including basic wages. But some localities are taking countermeasure to ensure that local revenues increase." The new fiscal constraints, accordingly, created a strong incentive for local officials to reconsider the development strategy in order to ensure the economic growth in accordance with local conditions.

### **3.3.2 The Cadre Evaluation System**

The cadre evaluation system<sup>69</sup> has a powerful influence on local cadre behavior because it has created strong constraints on and incentives for local cadres. On the one hand, local cadres seek to maintain and expand their positions of power in terms of career advancement and political legitimacy. On the other hand, the system has linked local cadre performance to material goods in terms of remuneration (bonuses) and rewards. The first cadre evaluation document was formulated in 1979 by the Organization Department of the CCP Central Committee calling for the establishment of a new system of cadre evaluation. According to the initial document, the new evaluation system should cover political and policy thought (*zhengzhi sixiang shuiping*), organizational and leadership competence (*zuzhi lingdao nengli*), familiarity with substantive issues (*shuxi yewu de chengdu*), implementation of democratic centralism (*zhixing minzhu jizhongzhi*), and actual achievements (*gongzuo de shiji chengxiao*). Furthermore, the evaluation system linked both material rewards (i.e. bonuses) and immaterial rewards in terms of promotions. In turn, penalties were to be included in the system as well, for example, demotion or transfer (Whiting 2001, p. 101). In 1988, an official guideline for the annual evaluation of Party secretaries, mayors and other leading officials at county level was issued by the CCP Organization Department.<sup>70</sup> Table 3.4 illustrates that the evaluation criteria covered a range of indicators of local economy, rural industry, commerce, agriculture, family planning, education, infrastructure and forestry. Among the standardized and systematized evaluation indicators, local economy, industry and agriculture are apparently in critical positions, in particular the fiscal income and gross output value. These indicators reflect the critical importance of local economic performance contributing to the

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<sup>69</sup> China's cadre evaluation systems are divided into three categories. The first is carried out by the Organization Department to assess the cadres' behavior based on five dimensions: moral quality (*de*), capability/skills (*neng*), work attitude/diligence (*qin*), achievements/efficiency (*ji*) and integrity (*lian*); the second builds on target responsibility system to assess the administrative units within the vertical hierarchy; the third also builds on the comprehensive target responsibility system but to assess the performance of the "Core Group" (*lingdao banzi*) and is mostly used for cadres at county and township levels. See Tao et al. (2009).

<sup>70</sup> The cadres subjected to evaluation include Party secretaries, mayors and the members of the County Party Standing Committees (*xian dangwei changwu weiyuanhui*) that compose the "Core Group". Chapter 5 will further examine the group in Fugu County.



county leaders' career prospects and material rewards.

**Table 3.4: National Guidelines for Performance Criteria of Local Party and Government Leaders (1988)**

Category
Local Economy
- Gross National Product (GNP)
-National income per capita
-Rural income per capita
-Local budgetary income
-Local budgetary expenditures
- Fiscal income
-Taxes and profits remitted
Industry
-Gross value of industrial output (not including any output below the village level)
-Gross value of output of township-and village-run enterprises
-Labor productivity of state and collective enterprises
Agriculture
-Gross value of agricultural output (not including any output below the village level)
-Procurement of agricultural and subsidiary products
-Grain output
Commerce
-Retail sales
Family planning
-Natural population growth rate
Infrastructure
-Infrastructure investment realized
Education
-Nine-year compulsory education completion rate
Forestry
-Forested area

Source: Adapted from Whiting (2001), p.103.

As a rule, at the township level the criteria of cadre evaluation system were set by county offices of management and administration (*xian jingying guanli bangongshi*). The system took the form of key indicators and aimed to make party and government leaders responsible for the performance of the township in economic and sociopolitical norms (Whiting 2001, p. 103). Economic norms focused on industrial growth, while sociopolitical norms mandated the social order and provision of public goods. The indicators, on the one hand, reflected the priorities of county leaders and thus were a means of conveying the priorities to township cadres. On the other hand, they also helped county leaders to compare and identify the most competent township cadres for promotion and transfer within their county. My field observations validate Whiting's (2001) findings that township cadres face intense competition; promotions, demotions and transfers across townships within the county are very common for township leaders who are normally not tied to their township of origin. By contrast, village leaders usually served in their home villages.

County and township officials were all state cadres who received a basic salary from the state payroll. Their bonuses were contingent upon the completion of specific tasks and targets set by their upper level authorities and accounted for a large share of their incomes. The townships and their enterprises were measured each year primarily by the targets of rural industry in the form of output value, profits or sales and the provision of public goods additionally. Local cadres were rewarded with bonuses in accordance with the fulfilled or over-fulfilled targets. As Oi (1999, p. 49) demonstrates, "[i]f a branch of the Agricultural Bank, for example, went over its quota for growth of savings deposits, it was recognized at the prefectural level and its officials rewarded with a bonus. The size of the bonuses varied." The overall performance evaluation was recorded in cadres' personnel files and therefore could affect their career advancement (Whiting 2001, p. 104).

Similar arrangements were set in the administrative villages. However, the village leaders and collective enterprise managers were usually not state cadres and thus did

not receive any salary from the state payroll. Their performance was primarily measured by the gross value of industrial output and industrial profits, which determined their entire incomes. In particular, the contract for collective enterprise managers contained many specific targets, of which the most prominent were industrial output value and profit indicators. As Whiting (2001, p. 107) claims, “[b]y directly linking income and industrial performance, the cadre evaluation system created a very direct incentive for local cadres to take a personal interest in economic management.” In sum, the incentive structure contained in the cadre evaluation and fiscal systems impelled local cadres to promote rural industry in order to increase revenue and concurrently finance the social welfare programs and public goods devolved by the central state.

In 2006, the cadre evaluation system with its emphasis on actual achievement expanded to the social and political sphere. From then on, the GDP was not the only indicator with which to assess local officials' performance, and social development, public order and environmental protection became important criteria in the evaluation system as well.<sup>71</sup> In particular, nationwide maintenance of social stability became one of the most important factors of new strategic goal of building a “harmonious Socialist society” (*shehuizhuyi hexie shehui*). That being said, pursuing high economic growth to maintain social stability became the best choice to solve the current problems, because robust economic growth improves living standards and creates new opportunities to promote general optimism and acceptance of the current system (Lieberthal, 2003). In my field research, quite a number of grassroots cadres complained that maintaining the stability contained in the cadre evaluation system imposed tremendous pressure on them, and could entail massive negative impacts on their career prospects. Thus, local cadres had to balance concerns about public order,

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<sup>71</sup> See *Zhongzubu yinfa shishi difang lingdao banzi he ganbu kaohe shixing banfa* (Trial Measures for Evaluating Local Core Group and Leading Cadres Issued by the Organization Department of the Central Committee). Website of People. <http://politics.people.com.cn/GB/1027/4567774.html> (accessed 5 October 2015).

social welfare, environmental protection and economic efficiency.<sup>72</sup> In this sense, the concern about social and political targets could be seen as creating even greater demand for revenue in localities in order to finance social welfare programs, central policy implementation and comfort disadvantaged groups through redistribution mechanisms.

The “one item veto” rule (*yipiao foujue*) plays a crucial role in the cadre evaluation process. It formulates periodical “hard” targets that must be successfully accomplished by any means and imposes strong constraints on local officials’ overall achievements. As Heberer and Trappel (2013, p. 6) note, “[i]f one of the targets is not accomplished, all other achievements of the local leadership will be void, hence, a county or township leadership could not be classified as ‘advanced’, and promotion of the county and township party secretary or mayor is almost impossible.” The hard targets may vary across regions, but some common targets are established and applied nationwide, for example, improving the Party’s work style and building a clean and honest government (*dangfeng lian Zheng jianshe*), birth control (*jihua shengyu*), maintaining social stability as assigned by the center. In these regards, Fugu County’s cadres were confronted with four hard targets, including improving the party’s work style and building a clean and honest government, birth control, maintaining social stability in terms of social order (*shehui zhi’an*), dealing with complaints from the public (*xinfang gongzuo*), and production safety (*anquan shengchan*). Among them, preserving social stability is explicitly placed at the top of the county and town governments’ political agenda. In particular, the leadership responsibility system (*lingdao zerenzhi*), associated with target responsibility system (*mubiao guanli zerenzhi*), reinforces the responsibility pledges (*zeren shu*) of maintaining social stability work signed between a county and its subordinating agencies. The evaluation

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<sup>72</sup> For example, on the one hand, local cadres are faced with growing pressures of complaints from the public induced by land use (i.e. acquisition) and resettlement compensation. On the other hand, they are faced with the rising protests against the construction of chemical plants. These social complaints and unrest not only affect local cadres’ performance evaluation but also impede local economic development in a preferable environment.

of maintaining social stability is conducted every half year and the overall evaluation takes place at the end of each year. The compliance with preserving social stability is strictly checked according to the “one item veto” rule. Thus, it has a direct impact on the outcome of evaluations with regard to career advancement and bonuses, or punishment.<sup>73</sup>

### 3.4 Summary

In summary, the powerful fiscal constraints, associated with maintaining social stability have created enormous incentives for local officials to generate revenues. These are intended to finance rural development projects designed by the center or provincial authorities, social welfare programs devolved from the center, and compensate the disadvantaged populace through redistribution mechanisms so as to maintain a peaceful social order in the case of Fugu.

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<sup>73</sup> See *Changzhi caineng jiuann:fugu heyi kuaru zhongguo baiqiangxian xilie baogao zhiba* (Assuring A Long Period of Stability: Serial Report Eight on How Fugu County Steps into “China’s top 100 counties”). Website of Fugu County Government. <http://www.fg.gov.cn/Item/3788.aspx> (accessed 5 October 2015).

## **Chapter 4. Strategies of Growth: The Rise of Local State Entrepreneurial-Developmentalism**

### **4.1 Preamble**

This chapter first reviews the institutional background of rural private sector growth after the reform period, and the evolution of rural private industrialization in particular, the coal sector in Fugu County and the contribution of coal-endowed industry to the county's revenues in the institutional context. Then it examines how local officials in Fugu County use entrepreneurial-developmental mechanisms to protect and foster the county-wide economy. They have adopted both administrative and economic controls: granting licenses, ownership and capital control, designating commissioners, as well as inducements: providing credit and financial consulting, market and technical assistance, tax breaks and support funds and mediation. The last section examines the consequences of local state entrepreneurial-developmentalism: the state-business symbiosis and the shift of *principal* and *agent* roles.

### **4.2 Strategies of Development: Evolution in Rural Industry**

In response to the incentives embedded in the fiscal reforms and cadre evaluation systems, local cadres crafted management strategies in accordance with local conditions. This led to substantially different development outcomes from one locality to another. As Oi (1999, p. 58) argued, “[o]nly a portion of the countryside has successfully developed rural industry. Some areas have been left out of the overall trend of industrial growth and the prosperity that has come with it.” Geographic location and natural endowment are among the main reasons for effective rural industrialization. Fugu County owns an enormous coal deposits. Since the 1990s, Fugu has therefore produced lucrative coal-endowed revenues, a trend which began to sky-rocket in the 2000s. Moreover, the

evolution of privatization of rural enterprises in Fugu greatly reinforced the generation of government revenue.

#### **4.2.1 The Rise of Rural Private Sector in China**

The revitalization of private businesses has been one of the most controversial reforms introduced in the post-Mao era. Private enterprises and their entrepreneurs were strictly prohibited during the past two decades prior to the reforms because it was difficult for the CCP to tolerate the existence of private enterprises in a socialist economy. However, the private sector arose among the individual small businesses that were permitted in tandem with the inception of the household responsibility system (*jiating lianchan chengbao zerenzhi*) after 1978. Without question, the private sector proved an enormous success in China's development, in particular in the Chinese countryside, and became one of the most dynamic forces in Chinese economic growth. Yet the private economy was officially regarded as a "supplement" to the publicly owned economy and subjected to discriminatory policies and regulations, even after it gained legal recognition in 1988. In summary, the policy formation of the private sector has been involved in very sophisticated reforms: "the private business was first allowed discretely, at the local level, and worked into official policy only after it had proved itself and become a *fait accompli*" (Young and Yang 1994, p. 24).

The great success of the rural private enterprises may be attributed to free market forces, the entrepreneurial spirit of individual farmers and business people. Local governments and their cadres, as "local state corporations," however, also played a crucial role in initiating and facilitating rural enterprises, "using their organizational strength and superior access to resources and markets to become a dominant factor in rural industrial growth and allocation of investments and profits" (Oi 1998, p. x). It is therefore important to understand how centrally formulated institutional arrangements reshaped the local cadres' behaviors in the course of rural privatization.

The following section reviews the institutional background of rural private sector growth after the reform period, and then examines the evolution of rural private industrialization, in particular the coal sector in Fugu County, and the contribution of the coal-endowed industry to the county's revenues in the institutional context. The focus now will be on how local officials in Fugu County use entrepreneurial-developmental mechanisms to foster the county-wide economy.

#### ***4.2.1.1 Evolution in the Rural Private Sector***

According to official Chinese definitions, the private sector encompasses “individual enterprises” (*getihu* or *geti qiye*)<sup>74</sup>, i.e. non-agricultural businesses with fewer than seven employees, run by individuals or households, and “private enterprises” (*siying qiye*) that employ eight or more workers, owned by individuals, partnerships, or up to 30 shareholders (Young and Yang, 1994, p. 25). One of the primary drivers for the rapid development of individual enterprises was credited to the national inception of the household responsibility system (*jiating lianchan chengbao zerenzhi*)<sup>75</sup> at the end of 1970s, which became the first step in Chinese economic reform and replaced the production teams which had been contained in the commune and brigade systems of pre-reform China (Young and Yang, 1994). The household responsibility system, on the one hand, led to substantial agricultural production growth. On the other hand, it created labor surplus as the labor hours needed for agriculture were shortened. Therefore, agricultural laborers were encouraged to leave farming and diversify their economic activities by

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<sup>74</sup> The *registration* of individual enterprises was first permitted in the policy paper of “The Report on the National Meeting of Directors of The State Bureau of Industry and Commerce” dated March, 1978. According to Young and Yang (1994, p. 25), “The State Bureau of Industry and Commerce” (*guojia gongshang xingzheng guanliju*), the State Council bureau responsible for the registration and administration of private businesses, began to list statistics for rural individual enterprises from 1981, and by 1981 Provisional Regulations on Non-Agricultural Individual Businesses were also to apply, ‘in principle,’ to rural businesses.”

<sup>75</sup> The household responsibility system and its impacts have been extensively examined by scholars, for example, Christiansen and Rai (1996), Jacobs (2009).



entering more lucrative industries and selling their surplus output in the market on more liberal conditions than before. Thus the small-scale production activities that had taken place in the household sideline production (*jiating fuye shengchan*) underwent “exponential growth” (Christiansen and Rai 1996, p. 221). For example, the number of individual enterprises increased from 560,000 in 1980 to 961,000 in 1981, 1,504,000 in 1982, 4,195,000 in 1987, and 9,201,000 in 1988 (Lu 2003, p. 10).<sup>76</sup>

According to one policy paper, the small business category included a wide range of economic activities, including agriculture, industry, commerce, service and transport.<sup>77</sup> Another reason for the fast growth of individual businesses was in consideration of the employment of a large number of rural youths after returning to the cities. Some received further education, some became state employees, and others became private entrepreneurs (Christiansen and Rai 1996, p. 232). Yet the capacity of the officially categorized rural household sideline to absorb the surplus rural labor force was ultimately limited (Cai and Wang 2012, p. 220).

While small private businesses initially developed quietly and inconspicuously in rural China, the number of employees working in the larger private enterprises run by individuals or households (some cases, e.g. involving a fish pond contractor or the owner of a sunflower seed factory, gained some notoriety)<sup>78</sup> became a controversial topic in public discourse and finally entered the central policy agenda: whether enterprises employing eight or more workers were to be allowed. Historically, larger private enterprises employing eight or more workers were believed to engage in the exploitation

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<sup>76</sup> According to the statistics of the State Bureau of Industry and Commerce, the private enterprises were listed independent of the individual enterprises until 1988, thus the statistics showed above included the total of both sectors. (Large-scale private enterprises were during that period listed in statistics as “collective enterprises,” see discussion of this on Young and Yang, 1994, p. 25)

<sup>77</sup> The main decision to carry out the reforms was made at the 3<sup>rd</sup> Plenary Session of the 11<sup>th</sup> Central Committee of the Communist Party of China, in December 1978.

<sup>78</sup> For a discussion of the private economy, see Lu (2003, p.8) and Rosen (1987).

of labor.<sup>79</sup> In 1983, the Central Committee's so-called *Document One* introduced the rural reforms that not only endorsed the "individual enterprises," but also endorsed, in a paragraph that was not made available to the general public and only enforced "secretly" by cadres in charge of this policy, enterprises consisting of more than eight workers, i.e. *private enterprises*.<sup>80</sup> Only in 1988 were these larger private enterprises officially recognized and given legal status.<sup>81</sup>

#### ***4.2.1.2 The Emergence of TVEs and Rural Private Industrialization (1979-1983)***

In fact, the privatization of rural production that began in the period 1979-1983 saw many small private businesses emerge, run by the most successful local farmers - a new entrepreneurial class in rural China (Christiansen and Rai 1996). As a result of the unpublished endorsement in 1983, the vast majority of these private enterprises were not officially registered as such, but contained or hidden in the category "township and village enterprises" (TVEs),<sup>82</sup> which had evolved from the "commune and brigade

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<sup>79</sup> According to Whiting (2001, p. 36), "[t]he distinction between the individual household firms and private enterprises is based on the notion that owners of individual household firms are themselves directly involved in labor, while owners of larger private firms that employ eight or more workers, are engaged in the exploitation of labor. The cutoff of eight employees is derived from Marx."

<sup>80</sup> See Christiansen (1989) and Christiansen and Rai (1996).

<sup>81</sup> The legal status is recognized in the *Amendments to the Constitution of the People's Republic of China* passed at the First Session of the Seventh National People's Congress on April 12, 1988. See *Zhonghua renmin gongheguo xianfa xiuzhengan* (The Amendment to the Constitution of the People's Republic of China). Website of Chinaonline. <http://www.china.com.cn/chinese/SFKSZN-c/80704.htm> (accessed 5 October 2015).

<sup>82</sup> According to Christiansen and Zhang (1998), township and village enterprises (TVEs) are an umbrella term that refer to any non-agricultural enterprises located in rural areas. They include both enterprises owned collectively by the townships, the towns or the administrative villages and those owned privately by farmers, by partnerships and by shareholders. Also see the definition provided by the Ministry of Agriculture (1985).

enterprises” (*shedui qiye*) and “sidelines” (*fuye*) of the People’s Commune system.<sup>83</sup> The unexpected upsurge of TVEs was, in other words, a key trigger in the process of institutional change in the past three decades.<sup>84</sup>

In addition to the inception of the household responsibility system which freed large quantities of labor from agriculture, another important aspect concerning TVE origins was the restrictive rural labor policy of “encouraging farmers to leave their farmland but not their hometown” (*litu bulixiang*), and “enter the factory without going to the city” (*jinchang bujincheng*), which the central authorities and experts issued in order to resolve the rural labor surplus problem (Li 2012, p. 220; Cai and Wang 2012, p. 219). For this reason, the then existing commune-and-brigade-run enterprises (*shedui qiye*)<sup>85</sup> were revitalized to absorb the surplus rural labor force. These precursors of TVEs were considered to be rural collective enterprises owned by production brigades or people's communes, and were required to increase rural employment opportunities and transfer their profits to the communes and brigades, respectively. Initially, an important feature of the TVEs was to provide local non-agricultural incomes for farming families.

In 1983, following the central policy, most rural enterprises became independent of the

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<sup>83</sup> The literature on TVEs has been extensively studied by economists and political scientists. For example, some economists argue that TVEs accelerated the speed of China's rural industrialization (Park 2001), fostered rural entrepreneurship (Huang 2010; Xu 2009, 2011); while others stress that TVEs contributed to China's overall economic performance by forcing the SOEs to join the market competition (Naughton 1995), pushing structural change in terms of labor shifting from the agricultural to the non-agricultural sector (Park 2001), playing a “catalytic role” in economic transformation (Naughton 2007, p. 271).

<sup>84</sup> Deng Xiaoping noted that for the Chinese leaders the rapid growth of TVEs came as an unexpected surprise in the rural economic reform, see Deng (1987b). Whiting (2010) and Oi (1999) argue that the problems produced by the pre-1994 system, associated with TVEs became an impetus for the 1994 reforms.

<sup>85</sup> Towns and townships replaced the people's communes and became the lowest-level jurisdiction of the Chinese state in October, 1983. See *Sange zhongyao wenjian yu xinshiqi zhongguo xiangcun zhengzhi de biange* (Three Important Documents and Political Transformation in China's Countryside during the New Era). Website of Peopleonline. <http://cpc.people.com.cn/GB/68742/69115/69120/4684361.html> (accessed 5 October 2015). Following the reform of commune system, the term of TVEs officially replaced the commune-and-brigade-run enterprises in a central policy document dated March 1984. See Document No. 4, 1984.

collective structures. Christiansen and Rai (1996, p. 230) noted that, “[s]ome were based on contracts with the director, who leased the enterprise, paying a fixed lease to the collective; others were based on appointment of directors, who had to transfer part of the profit to the collective; others were based on joint management between a number of persons; and yet other [mainly small] units were auctioned off or sold directly.” Under these circumstances, a broad range of TVE ownership forms emerged, encompassing individual, joint household (*lianhu*), shareholding cooperative (*gufen hezuo*), private, village-owned collective, township-owned collective, neighborhood-committee-run, and town-owned collective enterprises. The TVEs were registered at county level and managed by the industrial and commercial administrations established by township and town governments.

The range of forms of ownership falls mainly within the broad categories of collective and private. In the collective category are township-run, and village-run enterprises; domestic state-collective joint ventures (*jiti lianying qiye*); the government-run variant of shareholding cooperatives (*jiti gufen hezuo qiye*); and individually contracted collectives (*geren chengbao jiti qiye*), the assets of which originated in collective investment. In the private category are individual household firms, private enterprises, joint household enterprises (*lianhu qiye*), and the private variant of shareholding cooperatives (*siren gufen hezuo qiye*). Individually contracted “fake collectives” (*jia jiti*) were based on investment by private individuals, but falsely registered as “collectively-owned.”

In theory, the ownership of collective enterprises was directly retained by and subordinate to the towns and townships. In any case, these enterprises were not controlled by the state plan,<sup>86</sup> but constrained by policies and rules completely different from those regulating the state sector and urban collective enterprises (Christiansen and Rai 1996). However, the many diverse enterprises and new, vaguely defined ownership forms of TVEs initially caused problems. The primary problem was the fact that many enterprises were privately-

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<sup>86</sup> In particular, they were not subject to output quotas; in reality, the state plan authorities had since the early 1970s set aside quotas for supplying raw materials and other production factors for TVEs.

owned but officially registered as collectively-owned, often referred to as “red cap” enterprises (*hongmaozi qiye*) (Christiansen and Rai 1996; Sachs et al. 2002; Woo 1996). The registration of these “fake collective” (*jia jiti*) enterprises (and the associated practice of “doing business under pretense” (*guahu jingying*), for example by borrowing official stamps and collective company registration papers to conduct private business) has been interpreted by some as an effort to disguise their true private ownership in order to benefit from “lower tax rates, easier approval procedures, less restrictions on the size and operations of the enterprises, and shelter against possible reversal in the political fortunes of the reformers. And it is commonly believed that the number of red-capped private enterprises is greater than the number of registered private enterprises” (Woo 1996, p. 315). The collective enterprises were indeed granted very attractive preferential policies from the state authorities, including initial 3-year tax holidays, access to bank loans, and other measures, yet it is important to point out that the registration of rural private enterprises in the “collective” category was mandatory until 1988, and that the benefit accruing to them seemed to be viewed positively by their “real” *private* owners, local authorities and the central policy makers alike, serving the purpose of local employment of “surplus laborers.”

#### ***4.2.1.3 Turning Point and Fast Growth (1984-1991)***

The tipping point in TVEs fast growth was mandated in two policy papers from 1984. Document No.1 in January 1984, as the watershed, clearly gave permission not only to small individual businesses, but also to larger private enterprises, albeit under the “red cap,” as long as they created profits and, even more importantly, employment. It also listed specific directives that guided local governments to promote private enterprises. In March 1984, the Central Committee and the State Council jointly approved the “Report on Creating a New Situation in Commune and Brigade-Run Enterprises”<sup>87</sup> that officially

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<sup>87</sup> See *Zhonggong zhongyang guowuyuan zhuanfa nongmu yuyebu he budangzu guanyu kaichuang shedui qiye xin jiumian de baogao de tongzhi* (Document No. 4, 1984: Circular Concerning the Report on Creating a New Situation in Commune-and-Brigade-Run Enterprises). Website of Xinhuanet. [http://news.xinhuanet.com/ziliao/2005-02/07/content\\_2558311.htm](http://news.xinhuanet.com/ziliao/2005-02/07/content_2558311.htm) (accessed 5 October 2015).

renamed the commune and brigade-run enterprises as TVEs. The policy report reaffirmed the former collective enterprises, now run by township and villages, together with the joint/cooperative and private undertakings that had grown up since 1978 and were set to become the center of the integrated rural development. It emphasized that TVEs provided inputs for agriculture, absorbed rural laborers, raised rural incomes and generated tax revenues. The document also noted that the enterprises were responsible for their own profits and losses, and urged local governments at all levels to support and guide the development of TVEs. The change in policy was thus an important factor in promoting the fast growth of rural enterprises, in particular the joint household enterprises, the private variant of shareholding cooperatives and individual household undertakings.

Joint and cooperative enterprises were within an opaque bracket of private ownership, but the surplus (or profit) generated by them was *de facto* privately owned and controlled by more than one household. It is therefore significant that a policy document from 1990 stipulated that they should be treated as real cooperatives under the general rules aimed to safeguard them as long-term enterprises with a strong commitment to their workers. According to the document, a minimum of 60% of after-tax profits should be reinvested in the enterprise in the names of the investors, in which 50% should be committed to public accumulation (*gonggong jilei*), and the remaining portion (40%) be used for the share of profits that was divided among investors (no more than 20%), and collective welfare within the enterprise (*jiti fuli*), and worker bonuses.<sup>88</sup> Public accumulation refers to obligatory investment capital that cannot be claimed as the individual property of the investors. The local government had no official claim on the assets and profits, but the enterprise itself as a cooperative enterprise did (Whiting, 2001, p. 160; Young and Yang 1994).

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<sup>88</sup> The specific portion of after-tax profits distribution was decided by local governments and varied from place to place. See *Nongmin gufen hezuoqueiyue zanxing guiding* (Provisional Rules on Peasant Shareholding Cooperatives) issued on December 25, 1997. Website of Ministry of Agriculture of PRC. [http://www.moa.gov.cn/zwlrm/zcfg/qtbmgz/200601/t20060123\\_540345.htm](http://www.moa.gov.cn/zwlrm/zcfg/qtbmgz/200601/t20060123_540345.htm) (accessed 5 October 2015).

The joint/cooperative household enterprises were, in other words, considered part of the collective economy and treated differently from the individual and private enterprises. They were taxed at collective rates, enjoyed tax holidays and preferential policy (tax deductions, exemptions and reductions), as well as bank credits. The explanation of the collective nature of these firms may be similar to the private enterprises that were registered as “red cap” collectives, i.e. to allay political fears of attacks on private enterprises and justify their legitimate role in the socialist system before private ownership was legalized.

The evolution during this period (1984-1991) of individual and joint/cooperative household enterprises involved a substantial growth, although the economic rectification campaign from 1989 to 1991 led private enterprises to again disguise their private nature (see Table 4.1).

**Table 4.1: The Share of Rural Township, Village and Private Enterprises in the Annual Growth in Gross Value of Output, Employment and the Number of Enterprises, 1978-91 (%)**

Year	Growth of Number of Enterprises			Growth of Employment			Growth of Gross Value of Output		
	Township	Village	Private	Township	Village	Private	Township	Village	Private
1979	0.3	-3.7	n.a.	4.5	1.7	n.a.	6.7	10.9	n.a.
1980	5.3	-6.7	n.a.	6.0	0.7	n.a.	8.7	7.9	n.a.
1981	-0.6	-7.4	n.a.	1.7	-3.4	n.a.	6.8	1.2	n.a.
1982	0.8	2.2	n.a.	5.5	4.2	n.a.	9.8	9.1	n.a.
1983	0.1	-1.5	n.a.	4.8	3.1	n.a.	11.0	9.1	n.a.
1984	18.8	44.9	n.a.	19.9	26.1	n.a.	-5.6	3.9	n.a.
1985	4.5	-2.1	146.9	12.4	5.4	116.3	2.3	3.1	14.3
1986	1.4	-9.0	29.4	7.7	2.3	28.0	5.4	2.8	24.9
1987	-1.3	-10.7	18.6	5.4	2.4	20.4	9.5	8.6	28.9

1988	0.8	0.3	8.6	3.9	3.6	13.8	13.5	15.8	32.0
1989	-4.2	-3.1	-0.8	-4.3	-2.8	-0.1	1.0	4.6	32.8
1990	-4.4	-5.7	-0.6	-2.1	-3.3	0.6	4.6	4.7	34.6
1991	-1.6	-0.6	3.5	4.2	3.4	3.6	16.1	14.4	35.8

Note: n.a.= not available

Source: Adapted from Young and Yang (1994), p.27.

According to the official statics, the number of TVEs in 1984 increased from 1,346,400 (1983) to 6,065,200, among which, those run by joint/cooperative and individual households accounted for 69.3%, the total income reached RMB 153.708 billion, which increased by 65.5% (Liu 2001). Furthermore, they have made up over 90% of the rural enterprises since 1987 (see Table 4.2). Nevertheless, Table 4.2 also illustrates that despite the rocketing growth in number, the private sector was still eclipsed by the collective sector in producing output value and providing employment before 1987.

**Table 4.2: The Share of Rural Township, Village and Private Enterprises in the Number of Enterprises, Employment and Gross Value of Output, 1978-91 (%)**

Year	Share of Number of Enterprises			Share of Employment			Share of Gross Value of Output		
	Township	Village	Private	Township	Village	Private	Township	Village	Private
1978	21.0	79.0	n.a.	44.5	55.5	n.a.	57.0	43.0	n.a.
1979	21.6	78.4	n.a.	45.2	54.8	n.a.	56.1	43.9	n.a.
1980	23.7	76.0	n.a.	46.5	53.5	n.a.	56.2	43.8	n.a.
1981	25.1	74.9	n.a.	47.7	52.3	n.a.	57.6	42.4	n.a.
1982	24.8	75.2	n.a.	48.0	52.0	n.a.	57.7	42.3	n.a.
1983	25.1	74.9	n.a.	48.4	51.6	n.a.	58.1	41.9	n.a.
1984	6.6	24.1	69.3	6.1	40.4	23.5	47.8	37.9	14.3
1985	3.4	11.7	84.9	30.3	31.7	38.0	41.7	33.4	24.9
1986	2.8	8.6	88.6	28.7	28.6	42.8	39.9	31.1	28.9
1987	2.4	6.6	91.0	27.2	26.4	46.4	38.3	29.6	32.0



1988	2.2	6.2	91.6	26.1	25.2	48.7	37.5	29.6	32.8
1989	2.2	6.0	91.8	25.4	24.9	49.6	36.0	29.4	34.6
1990	2.1	5.8	92.1	25.2	24.4	50.4	35.3	28.9	35.8
1991	2.0	5.6	92.4	25.3	24.3	50.4	36.8	29.6	33.6

Note: n.a.= not available

Source: Adapted from Young and Yang (1994), p.27.

#### ***4.2.1.4 Restructuring and Privatization of TVEs (1992-2003)***

Private TVEs contributed notably to the national economy, and provided a much needed source of employment. By 1987, they produced one-third of the total output value and employed one-half of the workers in rural enterprises (see Table 4.1). The state recognized its significance and sought to mitigate the negative impact of the national economic austerity program (1989-1991). It therefore issued a package of policy measures to accelerate a further market-oriented privatization process, famously signaled by Deng Xiaoping on his “South China tour” in 1992. The relaxation meant that the “red capped” private TVEs removed their collective guise and became real private ones. An official press release formulated it in this way:

As China heads toward a market economy, an increasing number of private companies are no longer feeling the need as register as “red cap” or collectively-owned ventures...because the difference in preferential treatment between private and public units has been narrowed. [...] But there is a problem. The collective units are now arguing that private firms could not have developed without their help. As the so-called “owners” of the companies, the state firms usually ask for high compensation for the “divorce” or ask the companies to merge with them (*China Daily*, November 4, 1994 as cited in Woo 1996, p. 318).

Concurrently, the state restructured the ownership of TVEs. The reform involved various practices in order to resolve problem reported in connection with the TVEs, such as “capturing the market share of the large SOEs, wasting resources, creating pollution in rural areas, providing poor-quality products, distorting the market by rent-seeking actives.

TVEs also suffered from a slowdown in growth rate and deterioration in main management indicators” (Zou, 2003).

The conflict between local governments and the TVEs became a prominent problem in rural areas due to the vaguely-defined property rights. As noted earlier, the fiscal reform in the 1990s imposed heavy burdens on the collective TVEs by local governments. As the owner of the collective TVEs, local cadres extracted heavy taxes and profits to generate revenues, referred to as “killing the hen to get the eggs” (*shaji quluan*) or “draining the lake to catch fish” (*jieze eryl*). As a result, many TVEs were on the edge of bankruptcy. Under these circumstances, a restructuring and an explicit justification for the ownership was urgently needed. The ownership of TVEs was shifted from collective to private in various forms. They became shareholder companies or shareholder cooperatives; they were sold or half-sold-half-leased; they were auctioned off; they were merged into enterprise conglomerates (*qiye jituan*) that combined several corporations led by a “backbone enterprise” (*gugan qiye*), or a “leading enterprise” (*longtou qiye*).<sup>89</sup> Most local governments preferred the shareholder company or shareholder cooperatives patterns. In these types of enterprises, the owners equally issue shares or bonuses to employees (Young and Yang 1994; Zou 2003). Unlike the common shareholding company where the minority who own the dominant shares are the sole decision makers, the shares owned by the employees in the shareholder company or shareholder cooperatives are non-voting shares which cannot be traded in stock market, but which afford the employees decision making power based on their posts in the enterprise. Although employee shareholder companies and shareholder cooperatives have the hallmarks of private ownership, their official status is ambiguous, and their owners, in practice, comply with this vague definition to preclude any negative effects on business (Fan and Chen 2005).

Collective-converted-shareholder TVEs are assumed to be independent legal persons, but still have to fulfill the obligations of employment, financing public goods and social

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<sup>89</sup> The terms are used interchangeably. See Fan and Ma (1994, p. 132); Zhang (1990, p. 180).

programs. The practice of directly restructuring TVEs into shareholder/cooperative enterprises turned out to be not as successful as expected. As the restructuring of TVEs went on, the drawback of the collective-converted-shareholder model became obvious. One explanation claims that the worker-owned, i.e. *cooperative*, ownership brought about inefficiency in the TVE management and development because the vaguely mixed ownership put the managers in disadvantaged positions when they managed the so-called “owners,” in actuality the employees (Fan and Chen, 2005). On top of it, the fiscal form in 1994 caused the TVEs to shrink. The fiscal policy regulated that all enterprises must pay value-added taxes that dominated the rural enterprises’ tax categories. Moreover, central and local governments shared the value-added taxes in the ratio of 75:25 (i.e. the central government received 75% of the value-added tax, and the local retained 25%). However, the central, not the local governments, bore the risk of business losses and/or bankruptcy. Local governments, as a consequence of the tax reform, took higher risks but enjoyed fewer benefits from running collective TVEs, while collective TVEs lost their tax advantage and became a burden for the local government, since the surplus accruing to local governments from their collective TVEs was radically reduced. In 1996, the number of loss-making TVEs reached 1,970,000 or 8.4% of the total TVEs (Fan and Chen, 2005). Therefore, the local governments were motivated to further restructure the collective TVEs by either selling out the big and efficient ones or transferring the small and inefficient ones to the ownership of the existing managers. By end of the 1990s, the restructuring of the collective TVEs was completed and collective TVEs were consequently transformed into private enterprises.

Following the privatization of TVEs, the development of TVEs created the conditions for institutional change towards a freer market. During the transformation, market mechanisms became increasingly active, and the financial institutions relaxed restriction on the private sector. In the meanwhile, the legal protection of private property rights was also improved<sup>90</sup> and the state eliminated the tax discrimination in order to encourage the

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<sup>90</sup> See Article 13, in the Amendments to the Constitution of the People’s Republic of China passed by the Second Session of the Tenth National People’s Congress on March 14, 2004. Website of the National People’s Congress of PRC. [http://www.npc.gov.cn/englishnpc/Constitution/node\\_2825.htm](http://www.npc.gov.cn/englishnpc/Constitution/node_2825.htm) (accessed 5 October 2015).

growth of private enterprises. The success of TVE reform laid the foundation for the later SOEs reforms.<sup>91</sup> The positive roles of TVEs and the entire private sector played in the economic transformation persuaded the government and public to improve the policies and attitudes towards the private sector. All of these, in turn, created the conditions for further development of TVEs.

#### **4.3 Fugu's Strategies of Growth: Local State Entrepreneurial-Developmentalism**

China's localities had adopted corporatist systems to foster the growth of rural enterprises in the 1980s as the local state held the rights to the surpluses generated by collectively owned TVEs. The evolution of the local state from a corporatist state to an entrepreneurial-developmental state since the late 1990s took place against the background of privatization and fiscal reforms. The privatization of TVEs and small-scaled SOEs fundamentally altered the role of local officials from owner of enterprise to tax collector. Local governments therefore resorted to inducing investments (*zhaoshang yinzi*) through, for example, preferential policies as a significant strategy to expand the tax base. The tax division system that took effect in 1994 allocated the lion's share (75% of the value-added tax) to central government leaving only 25% for local public budgets. The local state retained the sales tax and local enterprise income tax, fiscal incomes from which local governments had to finance the devolved obligations to provide social welfare and public goods in their jurisdictions. The local state, accordingly, discovered that extracting tax revenues from local enterprises was an important strategy for promoting the growth of the rural economy.

Under the framework of local state entrepreneurial-developmentalism, China's local

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<sup>91</sup> In 1995, inspired by the efficiency of TVEs, the state issued a policy to focus on retaining major SOEs, and let go of minor ones (*zhua da fang xiao*). The restructuring of SOEs was carried out in various forms. Some became shareholder companies or shareholder cooperatives; some were sold or half-sold-half-leased; some were auctioned off; some were merged into enterprise conglomerates; some were contracted by or leased to individual entrepreneurs.

development strategies varied across localities. Local cadres adopted various strategies in accordance with local conditions and natural endowments. Taken as a whole, “[c]ounties, townships and villages in China’s countryside have shown impressive flexibility and an ability to face problems and adopt timely development strategies that are suited to changing political and economic conditions” (Oi 1999, p. 93). Fugu is such a county: local cadres have adopted coal-endowed development strategies to boost the county-wide economy through financing its public goods and raising funds for rural development projects.

Before China's economic reform began, coal mines “were largely state-owned, state-run, and exempted from market competition. There were small mines operated by townships/towns (formerly the communes *gongshe*) and villages (formerly the brigades *dui*) from the beginning, but their overall output was generally below 5% of the total production before 1970” (Wang 2006, p. 6). In the mid-1970s, small-scale coal mines run by township and village (TVE coal mines) began to grow and their output reached the level of 15% of the total due to the rise of local industry. TVE coal mines began to skyrocket in the 1980s when the rapid economic growth and development of TVEs increased demand for coal. In response, the central government loosened control over the coal sector and issued policies of “turning on the tap” (*you shui kuai liu*) to encourage coal mining activities, in particular in TVE coal mines wherever possible and by whatever means.<sup>92</sup> As Wang (2006, p. 7) notes, “[f]ollowing the central agenda, local governments gave the green lights to just about anyone who wanted to sink a shaft: townships, villages, individual cadres and farmers. The rush for coal resulted in a rapid proliferation of TVE mines. Whereas there had been only around 10,000 TVE mines in 1980, the number swelled to over 100,000 by 1991.”

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<sup>92</sup> Between 1983 and 1985, the central government had issued a series of policies to promote the development of TVE coal mines. For example, the State Council issued Eight Countermeasures to Develop TVE Coal Mines. Following the policies, local governments, township and village collectives, and individuals were encouraged to mine coal from large to small scales by all means. See *Nengyuanye 60 nian* (60 Years of Energy Industry). Website of Chinaonline. [http://www.china.com.cn/news/60years/2009-07/29/content\\_18229811.htm](http://www.china.com.cn/news/60years/2009-07/29/content_18229811.htm) (accessed 5 October 2015).

At the same time, the central government decided that Shenhua Group, a SOE, should start to develop and mine the Shenfu-Dongsheng coalfield.<sup>93</sup> The fiscal reform and cadre evaluation system incentivized local cadres to generate new sources of revenues. The specific resources and local conditions determined how local officials responded. Standing on the enormous coal field, local cadres in Fugu County greatly encouraged local people to engage in coal mining by granting mining licenses at the symbolic cost of RMB10.<sup>94</sup> These TVE coal mines were run in various forms, for instance, by county, township and village governments, government departments, individually as joint individual or collective enterprises. The general relaxation of control over coal mining during the middle and late 1980s facilitated Fugu County's entry into a golden age of TVE coal mining. There had only been 103 coal mines in 1985. By 1989, the number had surged to 248, among which 162 mines operated by individuals or as individual joint enterprises, accounting for 65% of the total number of TVE coal mines (see 4.3).<sup>95</sup>

**Table 4.3: Ownerships of TVE Mines in Fugu County (1989)**

Ownership	Number	Percent of Total
County	3	1%
Township	38	15%
Village	28	11%
Administrative Unit	12	5%
Collective Alliance	5	2%
Individual Alliance	2	1%
Individual	160	65%
Total	248	100%

<sup>93</sup> On June 3rd, 1986, the State Council issued the Decision on Promoting the Development of Coal Industry. See *Fugu xianzhi*, p. 335.

<sup>94</sup> See Wang (2013).

<sup>95</sup> See *Fugu xianzhi*, p. 325-329.

Source: Own Compilation. See *Fugu xianzhi*, p.325-329.

In rapid succession, the massive increase in coal mining, associated with local officials' incentives, catalyzed a sudden escalation of coal-led TVEs in, among others, the chemical and transportation sectors during the middle and late 1980s. In the 1990s, the emergence of private ownership of rural industry was associated with an emergence of local state entrepreneurial-developmentalism. The local state's rights to the economic surplus from private enterprises ended. The role played by the local developmental state in the rapid growth of the private sector is a key to understanding, for it was obviously not "a manifestation of *laissez-faire* capitalism" (Oi 1999, p. 99). Instead, local cadres conducted positive interventions in the private sector.

This case study will focus on the case of coal mine restructuring implemented in 2007 and the emergence of local state entrepreneurial-developmentalism, explaining how local government in Fugu County used entrepreneurial-developmental institutions to regain ownership and control of the private sector in order to foster the county-wide economy in the 21st century.

#### **4.3.1 Coal Mine Restructuring in Fugu County: Regaining State Ownership of Private Enterprises**

The coal mine restructuring policy launched in 2007 is an energy strategy designed by the National Development and Reform Commission, aims to promote 13 large-scaled nationwide coal field bases. It is a strategy that has changed the ownership structure of coal enterprises, in other words, the local state has regained the ownership of private enterprise after the privatization of TVEs in the 1990s. The key point of the restructuring policy is using the large-scale coal mine to buy out, merge and ally with small mines. In reality, however, it's the state, province or local owned coal companies that take advantage to control the ownership of mines. For example, in the end of 2008, the piloting restructuring project was launched in the neighboring Shanxi Province that is adjacent to Fugu County in Shaanxi Province. The coal resource restructuring project in

Shanxi Province generally has not only reduced the shafts from 2,598 to 1,053, but more importantly turned the private coal mine sector into a state-dominated mix of private and public enterprises.<sup>96</sup>

However, unlike the policy of “one-size-fits-all” (*yidaoqie*) in neighboring Shanxi Province, the implementation of the TVE restructuring in Fugu County was based on entrepreneurial-developmental mechanisms to regain the ownership of private coal mine companies in order to control the private sector and serve the local state’s purpose of extracting tax revenues. In this sense, it argues that the property rights remain relatively stable in this region.

#### ***4.3.1.1 Administrative Controls: Granting Licenses***

In China, granting licenses is a regulatory measure to monitor business applicants and decide whether to give permission to certain business operations according to the political, economic and social atmosphere. As Oi (1999, p. 129) notes, “[t]he process of licensing in China reflects the corporatist nature of the relationship between business and the state.” Local cadres from county to village can all affect whether an application of license is approved. First, the applicant needs a residential certification (*juzhu zhengming*) and good standing from his or her village Party branch. Second, the applicant must apply to the branch office of the industrial and commercial administrative management bureau at the township level. To get the approval, the applicant needs bank verification of investment capital including minimum amounts of fixed and circulation capital. After the industrial and commercial administrative management bureau at the township level investigates and approves the application, the applicant can approach the county-level industrial and commercial administrative management bureau that finally decides whether to grant the license.

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<sup>96</sup> For more details of the Shanxi coal mine restructuring project, see Chen et al. (2010).



Against the political and economic background of the “turning on the tap” (*you shui kuai liu*) approach of the 1980s, Fugu County government had granted the mining licenses in a swift and cheap manner in order to promote the rapid expansion of TVE coal mines and thus to generate revenues. Once the license expired and was due for renewal, local officials in Fugu County, in order to gain control of the coal-led private sector, began to use other mechanisms to decide whether a license should be renewed. For example, they evaluated the input that the coal mine owners, the farmer-converted entrepreneurs, had contributed to the local state-led rural development program or fund-raising projects. Mr. Shao and Mr. Tian put it in almost identical terms, stating that the enterprises could get better access to the resource allocation (i.e. approval) than those that don't actively get involved in the ‘Double Hundred’ rural development project; this involves, for example, the approval or renewal of the fully-mechanized mining license, corporation expansion and resource integration during the period of coal mine restructuring.<sup>97</sup>

#### ***4.3.1.2 Economic Controls: Ownership and Capital***

The coal mine restructuring project in neighboring Shanxi Province mainly involved one province owned enterprise in regaining the ownership and control over the coal mines. However, on the one hand, the local officials in Fugu County were forced to implement the restructuring policy imposed by upper levels; on the other hand, the local state did promote entrepreneurial-developmental systems to protect and foster the county-wide economy. Just prior to the implementation of the central coal restructuring policy in 2007,<sup>98</sup> the local state had already started forming five conglomerates to control and retain private enterprise capitals within Fugu County, namely Fugu Coal Industry

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<sup>97</sup> INT-08-201211; INT-15-201211.

<sup>98</sup> The Coal Industry Policy was launched by the National Development and Reform Commission on November 23, 2007. See *Zhonghua renmin gongheguo guojia fazhan he gaige weiyuanhui gonggao 2007 nian di 80 hao: gongbu meitan chanye zhengce* (Coal Industry Policy). Website of Ministry of Commerce of PRC. <http://www.mofcom.gov.cn/aarticle/b/g/200712/20071205307849.html> (accessed 5 October 2015).

Conglomerate founded in 2007, Fugu Coal Chemical Industry Conglomerate founded in 2008, Fugu Magnesium Industry Conglomerate founded in 2008, Fugu Metallurgical Coal Conglomerate founded in 2008 and Fugu Special Alloy Conglomerate.<sup>99</sup> Almost all of the private enterprises were incorporated into the five coal-led conglomerates under various production categories between 2007 and 2008. In order to further control the private sector and capitals, the local state implemented a series of strategies in two patterns. First, in 2009, the local state-owned assets management company<sup>100</sup> incorporated five large private enterprises to set up one guarantor company, controlled by the local state through a 78% share of the capital.<sup>101</sup> In 2010, the same local state-owned company co-opted one of the five conglomerates (Fugu Coal Chemical Industry Conglomerate) to form a transportation infrastructure group, the controlling shares of which were held by the local state. The total registered capital is RMB 2 billion, of which the local state-owned assets management company raised RMB 1.06 billion and private enterprises RMB 0.94 billion.<sup>102</sup> Second, the local state united with the above mentioned upper-level provincial SOE to first establish a SOE in which the province controls 57% of shares and the county controls the remaining 43%, and then proceeding to establish, respectively in 2009 and 2010, two coal-chemical corporations to control two conglomerates (Fugu Coal Industry Conglomerate and Fugu Metallurgical Coal

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<sup>99</sup> The founding year of the Fugu Special Alloy Conglomerate remains unknown. For more details of the five Conglomerates, see *Wu da jituan* (Five Conglomerates). Website of Fugu County Government. <http://www.fg.gov.cn/Item/6393.aspx> (accessed 5 October 2015)..

<sup>100</sup> For the articles of corporation management, see *Guanyu yinfa fuguxian guoyou zichan yunying youxian zeren gongsi zichan yunying guanli banfa de tongzhi* (Curcular Regarding the Assets Management Methods of Fugu-owned Assets Management Company). Website of Fugu County Government. <http://www.fg.gov.cn/Item/4144.aspx> (accessed 5 October 2015).

<sup>101</sup> See *Fuguxian yinfeng rongzi danbao youxian zeren gongsi jianjie* (An Introduction of Yinfeng Guarantor Company's Businesses). Website of Fugu County Government. <http://www.fg.gov.cn/item/10770.aspx?typeid1> (accessed 5 October 2015).

<sup>102</sup> See *Fuguxian renda changweihui guanyu dashi gonglu jinzhan qingkuang de shichang baogao* (Report of Development of Dashi Road by the Standing Committee of People's Congress). Website of People's Congress of Fugu County. <http://rd.fg.gov.cn/show.asp?id=758> (accessed 5 October 2015). See *Fugu jiaojian jituan* (Fugu County's Transportation and Infrastructure Group). Website of Fugu County's Communication and Construction Group. <http://www.fgcc168.com/gsgk.asp?id171> (accessed 5 October 2015).

Conglomerate). So far, the local state has successfully used political strategies to control the ownership and capitals of the coal-endowed private sector. Which other entrepreneurial-developmental mechanisms did the local state adopt to carry out the control over the private enterprises?

#### **4.3.1.3 Commissioners and Board of Directors**

As is widely known, Fugu's coal mine owners and entrepreneurs spring from poor farming families. They are labeled as "farmers-converted entrepreneurs" (*nongmin qiyejia*, lit. "peasant entrepreneurs") and are people of humble educational backgrounds, most having only primary and/or junior secondary education. Considering their low educational level and shortage of professional training, the local government has played a significant and multifaceted role in designating commissioners and cadres to support the management of key corporations and projects, creating credit institutions for loans, providing financial, market and technical assistance through various platforms, tax breaks and support funds for private enterprises/mines. Furthermore, the town and village cadres have acted as mediators, intervening in conflicts arising between villagers and enterprises/mines in order to create a peaceful and favorable environment for their operations.

In 2010, to implement the government institutions reform, Fugu County Government discharged 87 county-level cadres above 53 years of age from their positions at county level. How and where could these cadres be deployed? According to the Decision by Fugu County Government Regarding the Cadres Resettlement and Incentives during the Reform in Government Institutions, the local state assigned 81 of them to the enterprises and villages to assist in their administration. They are called commissioners (*tepai zhuanyuan*) relocated to new functions but with their formal civil-service positions (*bianzhi*) continued in their original place of service.<sup>103</sup> Moreover, they still receive a

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<sup>103</sup> See *Fuguxian renmin zhengfu guanyu yangdingshu deng tongzhi mianzhi tiqian ligang de tongzhi* (Notice Regarding Cadre Deposition and Early Departure by the People's Government of Fugu County).

RMB 1,000-1,500 subsidy per month from their original work unit until retirement<sup>104</sup> Mr. Huang, the former president of the Party school of Fugu County and currently the Party secretary of one of the largest coal tar electrochemical companies in Fugu County, explained the reasons why the local state made such a decision:

One reason is that the state intends young leaders to move up to leadership positions as the old ones have low promotion prospects; the other is that while many entrepreneurs lack education and are getting old, people with better educational background are working in the government. The old cadres are expected to help the entrepreneurs to better understand the economic and social policies, and assist the enterprises in business administration, in particular the enterprises are not familiar with bureaucratic systems. Furthermore, the enterprises benefit from the communications between these old cadres and government.<sup>105</sup>

In this sense, some cadres are sent to villages, others are designated to key enterprises (*zhongdian qiye*) to assist in business administration. These cadres who join the businesses formerly held important positions and maintain a rich social and political capital. For instance, the largest enterprise (Group B) in the locality modeled by the local and provincial governments as an exemplary private corporate in Shaanxi Province has attracted quite a lot of influential cadres to function in its decision making. For instance, Mr. Yao, the chairman of the trade union, as well as the deputy director of the advisory committee of Group B, formerly worked as the Party secretary and director of Fugu's Rural Credit Cooperative. The advisory committee established a "Leading Small Group for Enterprise Restructuring" (*qiye gaizhi lingdao xiaozu*) that directed the restructuring of ownership and management of Group B towards a "western style" pattern in August 2009. Mr. Ye, the general manager assistant of Group B, was the former county mayor assistant in Fugu County. The two cadres are representatives designated to the company headquarters' decision making layer. Others have been deployed as managers in its

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Website of Fugu County Government <http://www.fg.gov.cn/Item/4291.aspx> (accessed 5 October 2015).

<sup>104</sup> See *Fugu zhashhi tuijin ganbu renshi zhidu gaige* (Fugu County Promotes the Cadre Personnel System). Website of Fugu County Government <http://www.fg.gov.cn/Item/3728.aspx> (accessed 5 October 2015).

<sup>105</sup> INT-14-201211.

subordinate company according to their strengths and specialization. For example, the agricultural development company of a giant conglomerate employs a cadre as its general manager who used to work in the government's poverty alleviation department. His experience and specialized knowledge contribute to strategically develop agriculture and improve farmers' livelihoods in the village receiving aid. On top of the control on the key private corporations, the local state has exerted further control over the private conglomerates during the coal restructuring period. For example, the general manager of the Fugu Coal Industry Conglomerate is the former director of the Coal Industry Bureau of Yulin Prefecture. In a word, control and political power is used by the local state to intervene in the locality's county-wide economy. Nevertheless, control is only one defining feature of the relationship between the local state and the private sector. The local state has concurrently offered inducements as strong state intervention contained in the entrepreneurial-developmental mechanisms.

#### ***4.3.1.4 Inducements for Private Sector: Credit and Financial Consulting***

To prevent the businesses from falling into decline due to the lessening of resource endowments, the local state has advised private enterprises to diversify their investment into, for example, real estate, finance and logistics sectors. However, the diversified business expansion faces shortages of capital. The local state has implemented a series of mechanisms to resolve the difficulties facing enterprises in raising capital and getting loans. As is widely known, private sector has difficulties in crossing the threshold for loans, especially the long-term loans provided by the commercial banks. Thus, the local state plays a middleman role in providing private sector with credit guarantee. In the above described example, dated January 2009, the state-owned assets management company raised RMB 30,000,000 to set up one guarantor company associated with five private enterprises. 78% of the shares are controlled by the local state.<sup>106</sup> Based on the

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<sup>106</sup> See *Fuguxian yinfeng rongzi danbao youxian zeren gongsi jianjie* (An Introduction of Yinfeng Guarantor Company's Businesses). Website of Fugu County Government. <http://www.fg.gov.cn/item/10770.aspx?typeid1> (accessed 5 October 2015).

platform created by the local state, the local state-controlled guarantor company has provided RMB 0.5 billion credit guarantee for 67 medium-sized enterprises by 2011, associated with 6 commercial banks.<sup>107</sup> Given the fact that the local state has adopted a package of measures to intervene in the private enterprises business management and operation, the entrepreneurs have indeed received quite attractive capital benefits to expand their business which lead to a booming county-wide economy.<sup>108</sup> As Mr. Qiu claimed:

Using the guarantor company, the government provides the guarantee, helping the owner of Group B to get a RMB 2 billion loan so that he can invest in his new business.<sup>109</sup>

The local state has invited several commercial banks to set up branches in Fugu County and encouraged the banks to lend to private enterprises. By 2013, 58 bank institutions had been established in the locality. On top of that, the local state created 15 micro-finance institutions and 4 pawnshops to support the private enterprises with capital-raising.<sup>110</sup> As stated above, the capital of these micro-finance institutions are from the private enterprises. For example, Group B, as a provincial exemplary enterprise, has established one micro-finance company with registered capital RMB 0.3 billion as well as one pawnshop under the county government's directives. These micro-finance institutions and pawnshops are strictly overseen and regulated by the local state for prevention of illegal

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<sup>107</sup> See *Fuguxian guoyou zichan yunying youxian zeren gongsi zuzhi yuangong xuexi lianghui jingshen* (Fugu County-owned Assets Management Company Organizes Employees a Learning of "Two Congresses"). Website of Fugu County Government. <http://www.fg.gov.cn/Item/681.aspx> (accessed 5 October 2015).

<sup>108</sup> In 2008, Fugu's private economy accounted for 67.4% county-wide economy, contribution rate reached 74%. See *Xianfu houfu gongtongfu: fuguxian goujian hexie shehui de xintansuo* (Getting Rich One after Another and Common Wealth-Fugu County's New Exploration of "Harmonious Society"). Website of Shaanxi Province Government. <http://www.shaanxi.gov.cn/0/1/9/42/123521.htm> (accessed 5 October 2015).

<sup>109</sup> INT-17-201211.

<sup>110</sup> See *Fuguxian jinrong jigou ji fei cunkuanlei jinrong zuzhi yewu fazhan qingkuang* (Development of Financial Institutions and Non-deposit Financial Agencies in Fugu County). Website of Fugu County Government. <http://www.fg.gov.cn/Item/6769.aspx> (accessed 5 October 2015).

fund-raising.<sup>111</sup> Although loan interest rates from these private credit institutions are higher than that from the commercial banks, they offer private enterprises access to easier borrowing. It is apparent that all of the credit institutions have had the explicit support of the local private sector.

#### ***4.3.1.5 Market and Technical Assistance***

Since the 2000s, in order to encourage the development of private enterprises, local officials have provided assistance in a number of ways, from creating a platform between technical colleges and enterprises, buyers and suppliers to helping with markets. For example, to provide the private sector with technical advice and market information, the local state has created the first nationwide county-level coal transaction center in Fugu County. The center acts as a transaction platform, collecting and analyzing market information for enterprises and customers. The ultimate goal of the local state-created platform is to promote the coal sales and bring in new revenues.<sup>112</sup>

Having realized that technology and innovation play a significant role in an enterprise's long-term development, the local state thus initiated and created a collaborative platform between technical colleges and enterprises in order to cultivate human resources in particular the special technicians and researchers for enterprises. Some enterprises choose to delegate the cultivation to the specific technical college. For example, the Fugu Coal Industry Conglomerate implemented a training program with one railway school in Taiyuan City to promote local railway development.<sup>113</sup> Some prefer to build up

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<sup>111</sup> See *Shaanxisheng xiao'e daikuan gongsi shidian guanli banfa* (Experimental Management Methods of Piloting Micro Finance Company in Shaanxi Province). Website of Fugu County Government. <http://www.fugu.gov.cn/item/6904.aspx?typeid=3> (accessed 5 October 2015).

<sup>112</sup> See *Fugu: daobi jizhi tuidong meihua qiye ziyuan zhenghe* (Anti-driving Mechanism Promotes Resource Integration of Coal and Chemistry Enterprises in Fugu County). Website of Fugu County Government. <http://www.fugu.gov.cn/Item/17982.aspx> (accessed 5 October 2015).

<sup>113</sup> See *Fugu meiyue jituan yu Taiyuan tielu jixie xuexiao xiaoqi hezuo qianqie yishi juxing* (Fugu Coal Industry Conglomerate and Taiyuan Railway Mechanical School Sign a Cooperation Agreement). Website

collaborations with research colleges. For instance, one coal corporation has built up a research base with one university in order to promote the technology of coal industry.<sup>114</sup>

Concerning troubleshooting of business issues, the local state has formulated a responsibility system (*zerenzhi*) for leaders in charge of key projects (*zhongdian xiangmu*). The projects are protected by the government and the developments of the projects are the main duty of the cadres and state. In 2013, when most enterprises encountered a financial crisis due to the sudden contraction of the coal market, the county mayor intervened to prop up the local market for coal by leading an official team to Hebei, Shandong, Inner Mongolia and other northern parts of China to investigate the coal market, seek customers and tie up with local coal suppliers.<sup>115</sup> He even intended to rent a place for stocking coal in Hebei Province in order to transfer and sell it through Hebei Province.<sup>116</sup>

#### ***4.3.1.6 Tax Breaks and County Support Funds***

Local governments in Fugu County at all levels have tried to help their private sector to weather the coal market crisis by directly granting economic assistance to enterprises through tax breaks, electricity price subsidies and support funds from their own channels. In 2012, the local state benefited the enterprises RMB 0.37 billion through tax waivers,

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of Fugu County Government. <http://www.fg.gov.cn/Item/640.aspx> (accessed 5 October 2015).

<sup>114</sup> See *Nanliang meikuang yu xi'an keji daxue xiaoqi zhanlue hezuo xieyi qianyue* (Nanliang Coal Mine and Xi'an University of Science and Technology Sign a Strategic Collaboration Agreement). Website of Fugu County Government. <http://www.fg.gov.cn/Item/7535.aspx> (accessed 5 October 2015).

<sup>115</sup> See *Fugu: daobi jizhi tuidong meihua qiye ziyuan zhenghe* (Anti-driving Mechanism Promotes Resource Integration of Coal and Chemistry Enterprises in Fugu County). Website of Fugu County Government. <http://www.fg.gov.cn/Item/17981.aspx> (accessed 5 October 2015).

<sup>116</sup> INT-18-201309.



fees and subsidizing electricity costs.<sup>117</sup> While in 2013, the local state returned RMB 0.84 billion of coal price adjustment fund to enterprises that had paid before the assistance policy was issued in 2012.<sup>118</sup> These measures of tax breaks and subsidies were very important in helping enterprises survive the stagnant coal market.

To foster the development of small and medium-sized enterprises, the finance bureau earmarks RMB 20,000,000 to subsidize small and medium-sized enterprises that encounter business operation difficulties.<sup>119</sup> To support the research and development of new products, in 2011, the local state established a RMB 0.1 billion science and technology innovation fund for private enterprises.<sup>120</sup> The foundation is funded by government financial input together with enterprise fund raising, in which, the state raised RMB 30,000,000 and enterprises raised RMB 70,000,000. The local government also invests RMB 10,000,000 to assist the enterprises in employee skills training. The support funds from county government are particularly valuable because enterprises have to pay off such loans in a number of ways, from granting fiscal loan discounts (*tiexi daikuan*), repaying the loan to free use of the funds. The money provided by the county is up to the county government to decide how much has to be repaid. When local funds are insufficient, the county government could even request project loans from the prefecture

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<sup>117</sup> See *Fuguxian gongye jingjiju 2012 nian zhuyao gongzuo wancheng qingkuang he 2013 nian zhuyao gongzuo anpai de baogao* (Report of 2012 Work Summary and 2013 Work Plan of Bureau of Industrial Economy). Website of Fugu County Government. <http://www.fg.gov.cn/Item/10307.aspx> (accessed 5 October 2015).

<sup>118</sup> In 2012, the provincial government issued a policy to waive the coal price adjustment fund at RMB 15 per ton and reduce half of the toll fee of coal transportation to help the coal industry to combat the economic crisis. See *Lianggeyue nei yunmeiche gaosulu shoufei jianban* (Toll Fee of Coal Trucks will be Cut Half within Two Months). Website of Fugu County Government. <http://www.fg.gov.cn/Item/8013.aspx> (accessed 5 October 2015). For details of Fugu County Government's measures, see *Fuguxian gongye jingjiju 2013 nian gongzuo zongjie* (2013 Work Summary of Bureau of Industrial Economy). Website of Fugu County Government. <http://www.fg.gov.cn/Item/13884.aspx> (accessed 5 October 2015).

<sup>119</sup> See *Tuijin chanye da tisheng shixian minying jingji xin gongxian* (Promote Industry Upgrade and Realize Private Economy New Contribution). Website of Fugu County Government. <http://www.fg.gov.cn/Item/2770.aspx> (accessed 5 October 2015).

<sup>120</sup> See *Fugu sheli 1 yi yuan keji chuangxin jijin zhichi minqi jigai* (Fugu County Establishes a RMB 0.1 Billion Innovation Fund in Support of Private Enterprise Technology Upgrade). Website of Fugu County Government. <http://www.fg.gov.cn/Item/3683.aspx> (accessed 5 October 2015).

of the province. For example, in 2012, the Fugu County Science and Technology Commission and Finance Bureau selected 21 projects to apply for the earmarked funds from their upper authorities.<sup>121</sup>

#### **4.3.1.7 Conflict Mediation**

Fugu County Government not only provides credit, funds and business development strategies to the private enterprises, more important, creates a favorable environment for business operation and development. The role of mediator is manifest in the service functions of the local state. For instance, the government makes plans for industrial parks (*gongye yuan*) and constructs the infrastructure so that the enterprises have access to carrying out large scale projects. Concerning land use and security, the local state tries its best to assist the enterprises in compensation issues. When conflicts arise, the local government immediately engages in the mediation until they are settled. As Mr. Tian put it, “[w]ithout the town government’s mediation, the enterprises/mines are not able to run their businesses in the villages.”<sup>122</sup> The government intends to secure a peaceful environment for business operations, which is just one of the reasons. In addition, redistribution and maintaining stability count as well.

Both county government and the private sector have benefited from the local entrepreneurial-developmental mechanisms. With the rapid development in the 1990s and 2000s of private enterprises, taxation has become more important both as a source of revenue and as a means of regulating and guiding the local economy. As Figures 4.1-5 show, on the one hand, the local state has achieved a substantial growth of the number, output value, profits, taxes, GDP and revenues of the private sector since the 1980s. The

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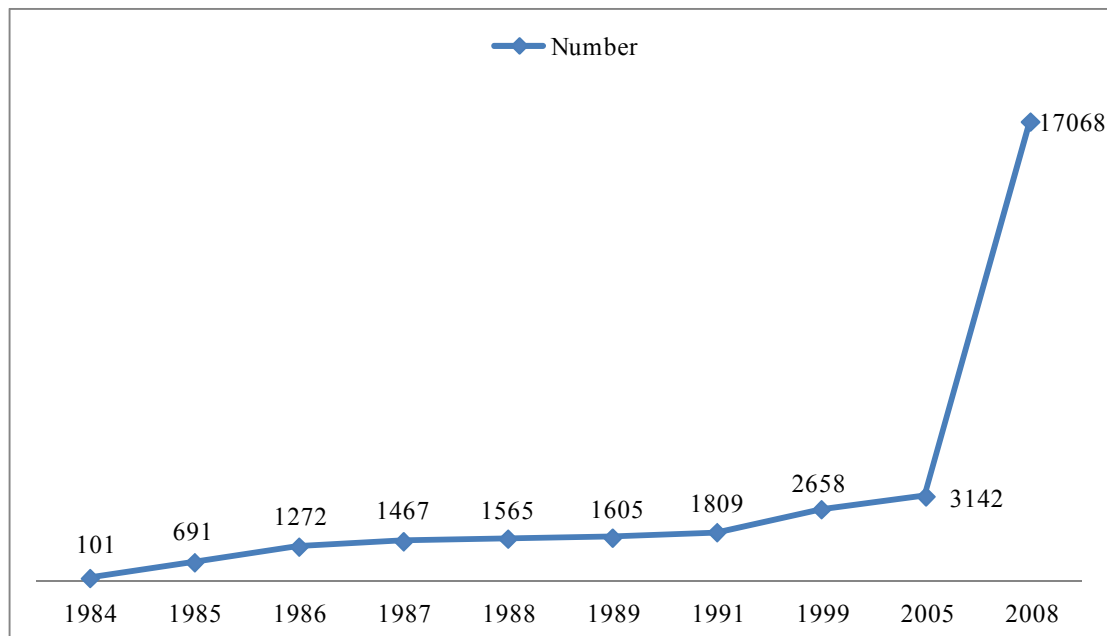
<sup>121</sup> See *Guanyu chengsong 2012 nian yulinshi keji zhuanxiang zijin xiangmu qingkuang de baogao* (Report of Application for Yulin Prefecture’s Earmarked Funds of Science and Technology, 2012). Website of Fugu County Government. <http://www.fg.gov.cn/Item/8765.aspx> (accessed 5 October 2015).

<sup>122</sup> INT-15-201211.

great jump of the above indicators took place in 2005, which was the year of a major coal price increase. The restructuring of the private coal sector and the founding of five conglomerates conducted by the local state between 2007 and 2008 reinforced the booming county-wide economy in terms of revenue extraction. On the other hand, the administrative and economic constraints as well as the inducements created by the local state have enabled the private enterprises to expand their business and maximize the benefits to the highest degree. As Mr. Qiu explained:

Whether the private entrepreneurs earn profits is determined by the environment created by the government. If the environment is not favorable, they may not make money. Fugu County Government has provided a lot of preferential policies and measures for the private sector. On the contrary, Inner Mongolia is just adjacent to Fugu County and owns enormous coal resources as well, but Fugu's entrepreneurs do not make such profits as here and are forced to return to Fugu County in the end.<sup>123</sup>

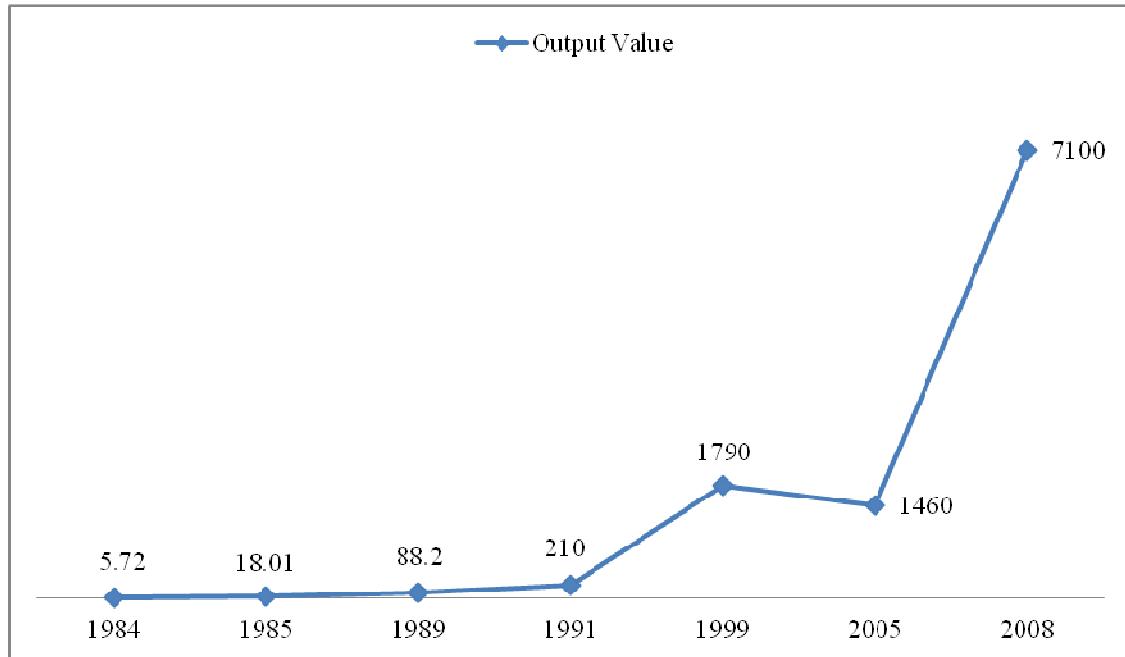
**Figure 4.1: Number of the Private Sector in Fugu (1984-89, 1991, 1999, 2005 and 2008)**



<sup>123</sup> INT-17-201211.

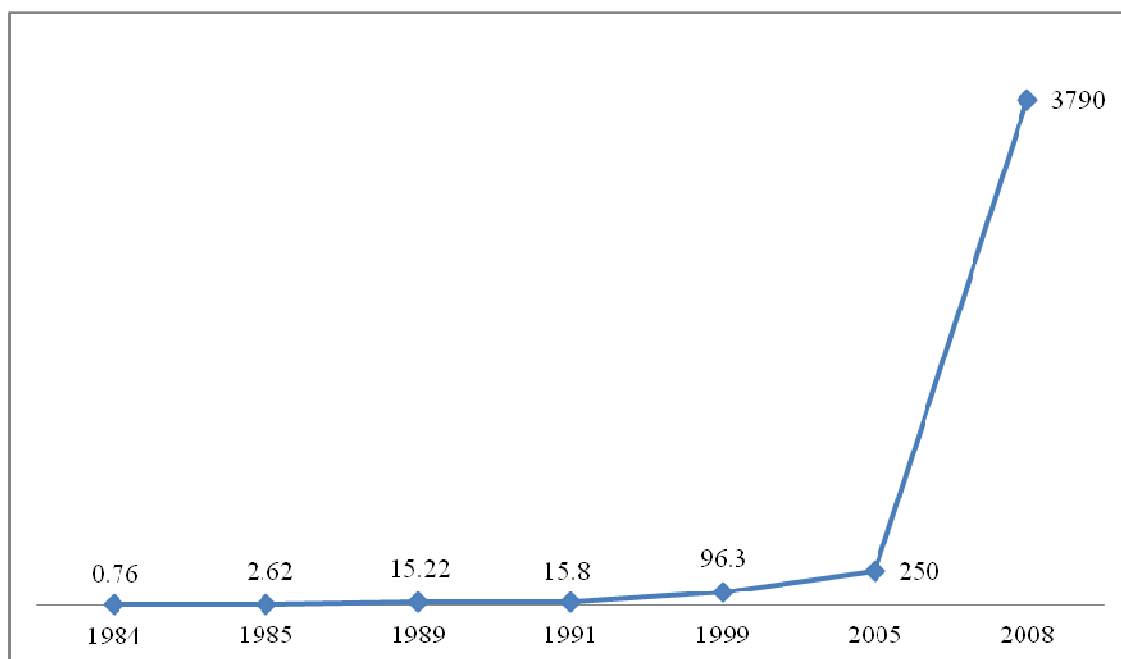
Source: Adapted from *Fugu xianzhi*, p.376 and Lu et al. (2010), p.18.

**Figure 4.2: Output Value of the Private Sector in Fugu (RMB Million) (1984-85, 1989, 1991, 1999, 2005 and 2008)**



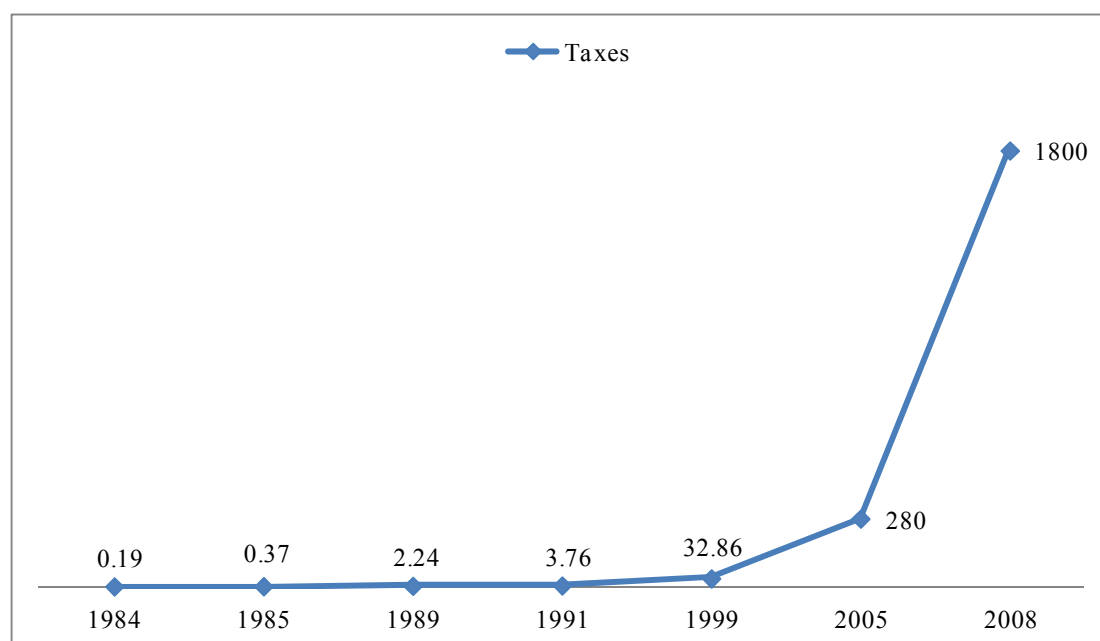
Source: Adapted from *Fugu xianzhi*, p.377 and Lu et al. (2010), p.19.

**Figure 4.3: Profits of TVEs and the Private Sector in Fugu (RMB million) (1984-85, 1989, 1991, 1999, 2005 and 2008)**



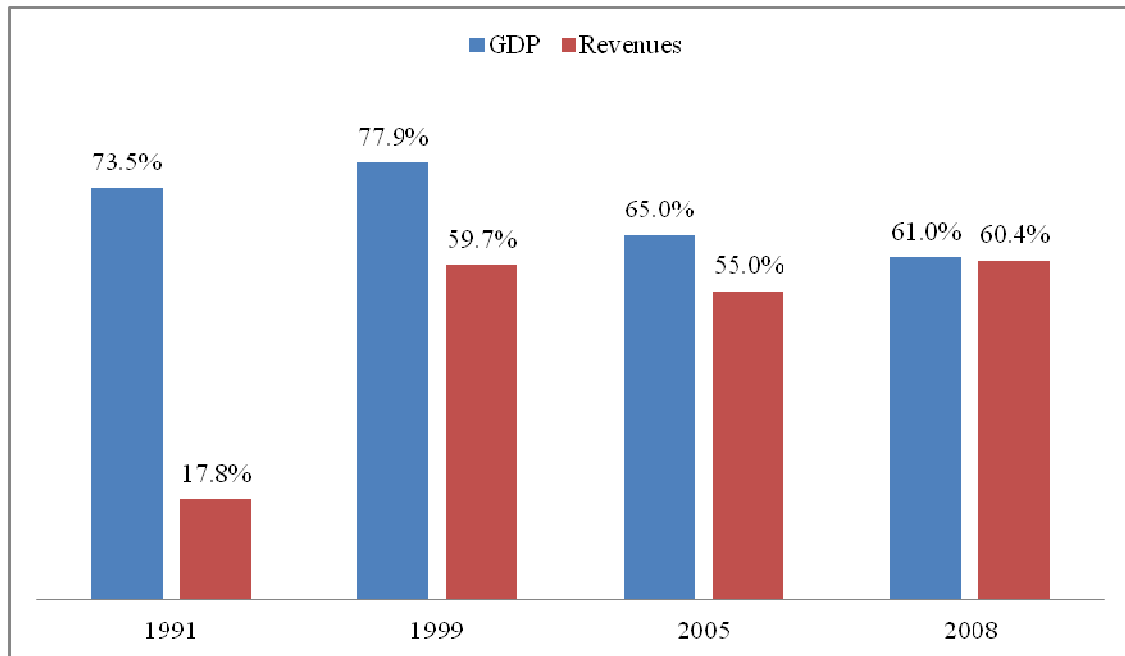
Source: Adapted from *Fugu xianzhi*, p.378 and Lu et al. (2010), p.19.

**Figure 4.4: Taxes of TVEs and the Private Sector in Fugu (RMB million) (1984-85, 1989, 1991, 1999, 2005 and 2008)**



Source: Adapted from *Fugu xianzhi*, p.378 and Lu et al. (2010), p.19.

**Figure 4.5: The Contributions of the Private Sector to County's GDP and Revenues (1991, 1999, 2005 and 2008)**



Source: Adapted from Lu et al. (2010), p.20.

### 4.3.2 The State-Business Symbiotic Relationship

The fast growth of the private sector driven by the local state implied that the locality has established symbiotic relations of mutual dependence between the private enterprises/mines and local government. In rural areas, where the private sector relied on the state to reduce risks while pursuing their economic interests, the relationship between the local state and the private sector are not likely to be adversarial. On the contrary, the local governments have used their control of resources in terms of capital and funds, coupled with technical and market assistance, to bring the private sector into the entrepreneurial-developmental fold. As for the local state, due to the constraint of revenue, the local state needs the corporations to provide funds for poverty alleviation and social development programs devolved from the center when facing the shortage of funds. In return, when the enterprises/mines encounter issues of market crisis, land acquisition, labor force and resources, they need the local governments to take

countermeasures by creating formal credit institutions, provide technical and market assistance and coordinate the interests between enterprises and villages. Aside from the resources and assistance, the corporations need the local governments' approvals for bureaucratic processes, including the granting and renewal of the business license, certification, prizes, and tax breaks.<sup>124</sup> In a nutshell, "a symbiotic relationship between officials and entrepreneurs that is conducive to economic growth is likely only in a stable political environment in which actors can afford to take a longer-term perspective, not a grab-and-run view, of their interests in the local economy" (Heilmann, 2008b, p.24).

The symbiotic relationship of mutual dependence between the private sector and local state is manifest in the mixed ownership structure that has appeared to provide connections and opportunities for private entrepreneurs. Early in the 1990s, "horizontal linkages" (*hengxiang lianhe*) form between large urban state and collective factories (at the county level or above) and rural enterprises was created in Fugu County.<sup>125</sup> These formations were based on production contracts according to which private enterprises would produce and assemble specific products and sell their products to large urban, collectively owned factories. The urban counterparts would supply the raw materials and provide product specifications. In this sense, the private enterprises had their contracts secured to minimize risks, reduce transaction costs and make profits by engaging in symbiotic relationships with the local government, specifically, the large state owned and collective factories. However, since the ownership structured altered in 2007, the symbiotic relationship between private enterprises and local state has been characterized by the mixed ownership structure. The evolution of "horizontal linkages" is present in the connection between private conglomerates and large state-owned enterprises because the private sector has difficulties in crossing the threshold for loans, especially the long-term loans provided by the commercial banks, while the state-owned sector has great

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<sup>124</sup> INT-15-201211.

<sup>125</sup> See Lu et al. (2010), p. 16.

advantages in capital and resource allocation.<sup>126</sup> The local state has gained control of the private sector by changing the local economic structure in terms of distribution of ownership.

Without question, Fugu's government plays a significant and multifaceted role in the symbiotic relationship in order to foster the county-wide economy that is the indispensable foundation for the poverty alleviation and social development programs. The role in the administrative and economic control in terms of granting license, regaining ownership and capital control through restructuring five conglomerates and designating commissioners and officials to manage large and key-point corporations/projects is only one facet of the local state. More importantly, the multifaceted role of the local state in the intervention has strengthened the implications for the symbiotic relationship between the private sector and local government. At county level, the officials create credit institutions, provide financial solutions, market and technical assistant through various platforms, tax breaks and funds for private sector. At town and village levels, the cadres act as the mediators, addressing the conflicts between villages and corporations/mines in order to secure peaceful and favorable conditions for corporations/mines operations. With the positive intervention conducted by the local state, the private sector is able to get through the period of economic crisis, continue their mining operations in conflicting villages and maximize their economic interests. Fugu County has been awarded a place in the "Top Ten Counties of County-wide Economy and Social Development" by Shaanxi Provincial Government for seven years since 2007 by virtue of the local state's developmental strategies with economic and social development approaches.<sup>127</sup>

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<sup>126</sup> See *Shenfu mingqi guoqi lianyin baotuanqunuan gongdunanguan* (The "Intermarriage" between Private Enterprises and SOEs to Weather the Hard Times in Shenmu and Fugu Counties). Website of Fugu County Government. <http://www.fg.gov.cn/Item/15839.aspx> (accessed 5 October 2015).

<sup>127</sup> For the accumulative awards of *Xianyu jingji shiqiangxian*, see Notice Regarding 2007 Top Ten Counties of County-wide Economy and Social Development and Ten Advanced Counties by the People's Government of Shaanxi Province. Website of Shaanxi Province Government. <http://www.shaanxi.gov.cn/0/104/6214.htm> (accessed 5 October 2015); Notice Regarding 2008 Top Ten Counties and Five Districts of County-wide Economy and Social Development and Ten Advanced Counties by the People's Government of Shaanxi Province. Website of Shaanxi Province Government. <http://www.shaanxi.gov.cn/0/104/6741.htm> (accessed 5 October 2015); Notice Regarding



The concrete economic foundation has promoted the effectiveness of the “Double Hundred” rural development project and other county-wide social development programs through entrepreneurial-developmental mechanisms. By contrast, another poverty alleviation project was not ideally implemented due to a lack of funds. In 2012, the local state initiated the 3331 poverty reduction project to pair corporations/mines with poor households, however, the upgraded program failed to raise enough money as it expected because the coal market price fell from RMB 400-500 per ton to RMB 200 per ton sharply. Thus the coal-related industries were thus constrained to support the poverty alleviation programs. As the town cadre claimed, up until September 2013 when I conducted the second fieldwork, Xinmin Town Government had not received a cent from enterprise, except for the transfer payment from county finance bureau for the new poverty alleviation program.<sup>128</sup> Moreover, the entrepreneurial-developmental mechanisms that are constrained by the rural economy have induced the repetition of conflicts in a dynamic way. Consequently, the farmers’ coal-based business, including job opportunities, leasing dumper trucks and service trade for coal transportation are affected by the coal business. As Mr. Qiu complained:

The conflicts between village and corporations/mines change from time to time. When the mines give money to the farmers, the conflicts are settled. The enterprise were willing to give money when they made good benefits, but now they are reluctant to give because they have trouble in

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2009 Top Counties and Districts of County-wide Economy by the People’s Government of Shaanxi Province. Website of Shaanxi Province Government. [http://govinfo.nlc.gov.cn/shanxsfsz/sxzb/201010/201104/t20110413\\_650772.shtml?classid355](http://govinfo.nlc.gov.cn/shanxsfsz/sxzb/201010/201104/t20110413_650772.shtml?classid355) (accessed 5 October 2015); Notice Regarding 2010 Top Counties and Districts of County-wide Economy by the People’s Government of Shaanxi Province. Website of Shaanxi Province Government. <http://knews.shaanxi.gov.cn/0/104/8278.htm> (accessed 5 October 2015); Notice Regarding 2011 Advanced Counties and Industrial Clusters of County-wide Economy by the People’s Government of Shaanxi Province. Website of Shaanxi Province Government. <http://knews.shaanxi.gov.cn/0/103/9165.htm> (accessed 5 October 2015); Notice Regarding 2012 Advanced Counties and Districts of County-wide Economy by the People’s Government of Shaanxi Province. Website of Shaanxi Province Government. <http://www.shaanxi.gov.cn/0/103/9919.htm> (accessed 5 October 2015); and Notice Regarding 2013 Advanced Counties and Districts of County-wide Economy by the People’s Government of Shaanxi Province. Website of Shaanxi Province Government. <http://www.shaanxi.gov.cn/0/103/10468.htm> (accessed 5 October 2015).

<sup>128</sup> INT-18-201309.

making good benefits, then the conflicts recurs. In addition, the farmers are not that considerate. If the corporations/mines give money to them to address the conflicts, they think the government and corporations are both good, but not vice versa.<sup>129</sup>

It is apparent that the significant role the local state plays in resolving the conflicts has further consolidated symbiotic relationships between the private sector and local government. Associated with financial, market and technical assistance provided by the local developmental state, the relationships have kept the private sector within the entrepreneurial-developmental fold.

#### **4.3.3 Principals and Agents**

Corporations, like all organizations in principal-agent relationships, face a few problems (Oi 1999; Whiting 2001). A main issue is asymmetrical knowledge: Agents always have an advantage over the principal due to their information about the true level of implementation and performance of business operations. Monitoring can be used by the principal to oversee and regulate agents' behavior and performance, however, the process is costly and less effective if the agents collude with partners to deceive the principal. Another issue is moral hazard: They are likely to use that knowledge to serve their own rather than the principal's interests. So for the principal, it is necessary to devise sufficient incentives that make it appealing to the agents to fulfill the principal's interests.

The agency problems described above appeared before the five conglomerates were restructured by the local state in Fugu County, where there were many different principals and agents. In the private sector, principal and agents consist of the same family members, which is a long-practiced tradition in China, in particular in the cottage enterprises (*jiating zuofang qiye*). This tradition has intensified the problems of information asymmetry and moral hazard. A large amount of evidence has shown how the principal

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<sup>129</sup> INT-18-201309.

colludes with agents when their illegal activities are found out, so that it becomes more difficult for the local state to oversee and regulate misconduct. For instance, a substantial tax evasion by the enterprises was revealed in Fugu County before 2006.<sup>130</sup> Obviously, this harmful behavior has increased the information and transaction costs of governing private firms.

Nevertheless, the new economic structure characterized by the restructuring of five conglomerates and the sent-down cadres (*xiapai ganbu*) in the private sector implemented by the local developmental state has intensified the agency problems in terms of asymmetrical knowledge and moral hazard. On the one hand, the principal is still composed of private entrepreneurs/shareholders, but the agents are composed of former local officials. Considering the low education levels and poor professionalism of the farmer-converted entrepreneurs, these officials are commissioned by the local state to manage the private enterprises/conglomerates. In this sense, the agents face two principals: the private entrepreneurs and the local state. The local state is the more immediate principal because the designated cadres' formal positions still remain in their original work units and they are still paid by the state and may not have received any salary from the corporation they serve.<sup>131</sup> Furthermore, the local state provides unified incentives and common interests for the agents, which is to promote the county-wide economy and generate revenue extractions. The incentives and interests are embraced by all local officials in Fugu County. On the other hand, the agents have the upper hand with regard to information. As they are commissioned by the local state to perform duties, they are likely first to protect the local state's interests by intensifying the regulation of the enterprises they serve. They act as the local state's internal monitors, overseeing and regulating the illegal activities the enterprises have conducted. Moreover, they can obtain

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<sup>130</sup> See *Guanmao ciji buchou youxiu qiyejia* (Official Caps do not Stimulate Excellent entrepreneurs). Website of Xinhuanet. [http://news.xinhuanet.com/comments/2009-02/05/content\\_10765628.htm](http://news.xinhuanet.com/comments/2009-02/05/content_10765628.htm) (accessed 5 October 2015).

<sup>131</sup> It is claimed by my interviewee, Mr. Huang, the former president of the Party school of Fugu County and currently the Party secretary of one of the largest coal tar electrochemical companies in Fugu County that he had not received any salary for 2012 at the time when I conducted my interview with him in Nov. 2012 (INT-14-201211).

and report first hand information of difficulties that enterprises have encountered, for example, land conflicts, license approval/renewals and fund shortages. To solve these difficulties faced by their secondary principals, the agents act as middlemen and use their political and social capital within their jurisdictions by reporting to and meeting with the local officials and visiting credit institutions. In a word, the officials, as the agents in the newly restructured conglomerates and private enterprises usually first protect the local state's interests and only second the private enterprises. This does not mean that the secondary principal's interests are not as important as that of the local state. Rather, it is also very important to maximize business profits because they are the necessary base of county-wide economy and revenue extraction. However, the role of the local state has shifted from sharing the residual of collectively-owned enterprises before they were transformed to private enterprises to expanding the tax base and collecting tax from the private sector. Therefore, the priority of safeguarding the local state's interests in terms of taxation regulation is given to the agents.

The agency problem in the newly mixed enterprises by a local state-owned enterprise controlling the shares is less complex because the local state has become the major principal and local officials are the agents. For example, the general manager of the mixed guarantor company described earlier is the deputy manager of the local state-owned assets management company. Other private shareholders form the minor principal but the agents fulfill more duties commissioned by the local state because their private entrepreneurs are seen as incapable of making decisions. In this sense, the private enterprises are simply incorporated by the local state in control over the capital and ownership. The agents are likely first to safeguard the local state's interests and only second the interests of their private partners.

The rise of local state entrepreneurial-developmentalism in the Fugu case has further intensified the moral hazard problem because it has increased the need of agents to first protect the local state's interests and second the private sector's. Rather, the principal-agent framework implemented by the local state has strengthened the regulation and monitoring of the private sector through controlling shares and ownership, retaining

capital within their jurisdiction.

#### **4.4 Summary**

First, this chapter has focused on a review of the institutional incentives of rural private sector growth after the reform period, and the evolution of rural private industrialization in particular, the coal sector in Fugu County. It has illustrated that the coal-endowed industry is accountable for a significant contribution to the county's revenues. Then I demonstrated how local officials in Fugu County used entrepreneurial-developmental mechanisms to protect and foster the county-wide economy. They have adopted both administrative and economic controls: Granting licenses, ownership and capital control, designating commissioners, as well as inducements: providing credit and financial consulting, market and technical assistance, tax breaks and support funds and mediation. Finally, I argued that the fast growth of the private sector driven by the local state implied that the locality has established symbiotic relations between the private enterprises/mines and local government. However, the new economic structure characterized by the restructuring of five conglomerates and sent-down cadres to the private sector implemented by the local developmental state has intensified the agency problems in terms of asymmetrical knowledge and moral hazard. Moreover, the officials, as the agents in the newly restructured industrial clusters and private enterprises, first protect the local state's interests before those of the private enterprises.

## **Chapter 5. Strategic Groups and Strategic Agency**

### **5.1 Preamble**

Following Heberer and Schubert's analytical approach to strategic groups and based on extensive interviews, documentary analysis and field-based observations, this chapter examines how the strategic group approach may help us understand the case of Fugu County. The emergence of the strategic group and the strategic agency played by local cadres in policy implementation are at the core of the chapter. It is presented in three parts. First, I identify the differences and features of various bureaucratic institutions, namely, the local state, the Party committee leadership small groups, and the strategic groups. Then I examine how the strategic group is established by leading county and town cadres and how local coal mine owners/entrepreneurs are incorporated in the strategic group. Next, I examine the strategic agency in the implementation of the "Double Hundred" project. Third, I look at the internal evaluation system and how CSR, as strategic agency of the redistribution mechanisms formulated by the local state.

### **5.2 Institutional Structures: The Party, the State and the Strategic Group**

Before examining the dynamics of strategic group, it is necessary to identify the differences and features of various organizational structures among the Party Committee leadership small group, the state/local people's government and strategic group in the policy-formulation and implementation process.

China's policy formulation and implementation process has been characterized by its intense interactions with the Communist political system since the reform era. As a formal political institution, the CCP has the ultimate authority and leads the work of the state while it is intertwined with the state and society. The formal and permanent structure

of the communist polity is constituted in the following manner: “At the apex of the CCP is the national Party organization headed by the Standing Committee of the Politburo, the Politburo, and the Central Committee, which are served by a Secretariat and other departments” (Shirk 1992, p. 60-61). Likewise, the leadership bodies, namely CCP committees, are established at provincial, municipal, county and town/township levels. Each government agency at national, provincial, municipal, county and town/township levels has its own Party committee. The Party leadership small group (*lingdao xiaozu*) is formed ad hoc to coordinate and consult over policies, in particular specific tasks. Even though the Party leadership small group within a government organ is much smaller than a Party committee, consisting only of three to five members (normally the Party secretary, the minister, and a few vice ministers), it is much more powerful than the Party committee in terms of appropriating the authority of the official heads of the government organ. As Yan (1988, as cited in Shirk 1992, p. 64) puts it, “[i]n the government setup, the CCP bypasses the government executives at all levels by leading all government departments directly through the 'leading Party groups' in government institutions.” Consequently, the Party members are recognized as having great prestige and authority, special political status and greater political authority on many matters than higher-ranking non-Party officials (Barnett 1967, as cited in Oi 1999, p. 141). The superiority complex and divergent interests are likely to create political obstacles in the path of policy making. The leadership small groups cast the roles in integrating officials in decision making across authority boundaries through formal meetings and tasks. The purpose of the formal bureaucratic institution is to comply with policy demands and resolve local interests by building consensus on issues that cut across the government agencies, sectors and subordinate units.

The State Council, as the highest central administrative authority under the leadership of the CCP, is formally in charge of policy making and conducting a wide range of government functions both at the national and the local levels. Its formal bureaucratic structures and local formation are vested in the local people’s governments, which are the organs administering the work at provincial, municipal, county and town/township levels. As the nominal actor authorized by the National People's Congress (NPC), the state is

limited in formulating policy due to the administrative borders and separation of authority. Thus both *formal* and *informal* coordination is needed in making and executing policies. The *formal coordination* is conducted by the party leadership small group within a governmental agency *at every level of authority* (i.e. center, province, prefecture, county, town/township).

The state and the CCP are tightly interlocked. Shirk (1992) defines the relation between the state and CCP as an “agency relationship” in which the CCP is the “principal” and the state is the “agent.” As argued above, because the CCP has formal political authority over the state by means of appointing and promoting government officials, the Party delegates authority to its agents, the government bureaucrats, in carrying out policies that conform to the Party’s demands. Furthermore, “the Party also sets the general policy line (*luxian*), which the government implements, and oversees the work of the government” (Shirk 1992, p. 61).

*Informal coordination* is here considered as taking place through what can be termed *strategic groups*. A *strategic group* is an open and informal network, consisting of people in various levels who share the common interests. The informal institutional structure is contained in a network established by influential people who can offer political, social and economic capital. In the case of Fugu County, the strategic group is established by the local state, incorporating both influential officials and coal mine owners/entrepreneurs. Informal coordination is needed in order to resolve local and individual interests and to achieve targets and carry out the cadre evaluation system.

Although the three institutional structures in terms of the Party, the state and the strategic group take formal or informal forms, they share overlapping lines of authority. It is very common to observe officials of the Party overseeing bodies playing dual roles by also serving the government agencies.

### **5.3 Strategic Group Dynamics: The Emergence of a Strategic Group**



Fugu County is a coal-endowed industrial county with a rapidly developing county-wide economy, where social problems and village-enterprise/mine conflicts are becoming increasingly prominent. There are four reasons that have intensified the social and environmental problems and village-enterprise/mine conflicts. First, Fugu County has been on the national list of the poorest counties since 1994, and the epithet of “poor county” was not removed until 2012 (Chapter 1). However, the regional economic development is very uneven in the county. The county center, its surrounding areas and the resource-rich western region have developed rapidly, while the purely agricultural eastern and southern regions are economically backward. The rural landscape has undergone no major change over the years. Second, regional inequality and disparity has widened. The structural (institutionalized) poverty is induced by coal mining,<sup>132</sup> which induced severe income inequality between coal mine owners and farmers. On the one hand, in the rich coal-endowed region, a large number of private entrepreneurs accumulate tremendous wealth through mining and business operations. On the other hand, farmers who control no coal resources still live below the poverty line. The increasing inequality between the high and low income groups consequently kindles farmers’ hostility towards people they regard as upstarts squandering money. Third, the destruction of the natural environment due to coal mining destroys the livelihoods and agricultural production of local farmers through air pollution, and degradation of water and land. In the mining areas of Xinmin Town, large quantities of toxic wastewater from coal mines are discharged after, at best, limited treatment. These effluents, combined with runoff from mine tailings, have badly polluted both surface and ground water in the mining areas, often contaminating soils and crops. Furthermore, buildings, roads and

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<sup>132</sup> The World Bank divides well-being into three aspects: Poverty is defined as whether households or individuals have enough resources or abilities to meet their needs; inequality in the distribution of income, consumption or other attributes across the population; and vulnerability, defined here as the probability or risk of being in poverty or falling deeper into poverty in the future. See Measuring Poverty. Website of World Bank.  
<http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTPOVERTY/EXTPA/0,,contentMDK:20202198~menuPK:435055~pagePK:148956~piPK:216618~theSitePK:430367,00.html> (accessed 5 October 2015). In this study, structural poverty also refers to institutionalized poverty, which is ultimately the result of structural failings at the economic, political, and social levels. For further discussion of poverty causes, see Rank et al. (2003).

croplands frequently suffer major incidents of land subsidence. In one natural village, for example, more than 120 farmers in 30 households have lived in temporary housing since 2009 after coal mining caused the land on which their houses stood to collapse. The temporary houses are hot in summer and cold in winter and will remain so until the relocation project funded by the responsible coal company is finished.<sup>133</sup> Fourth, there is a stark contrast between high incidence of poverty and low coverage.<sup>134</sup> In recent years, the local state has increased a large input into poverty alleviation practices. Nevertheless, the government's investment only scratches the surface due to the limited anti-poverty funds transferred from higher authorities and the large number of poor people in the rural areas.

In general, the financial constraints in terms of anti-poverty funds has created the prime obstacle in the rural development practice. Historically, being tagged as a “poorest county” brings multiple benefits to the county. For example, the county would enjoy the financial anti-poverty funds transferred from the central and upper authorities; the central government initiates pairing schemes to organize the coastal developed regions to aid the inland under-developed regions where the poor county is located; some large SOEs and public agencies also help the poor county to reduce poverty by all means; in addition to these, some industrial and fiscal preferential policies are ad hoc formulated for the poor regions in order to promote rural development.<sup>135</sup> In the case of Fugu County, the biggest

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<sup>133</sup> INT-20-201211.

<sup>134</sup> From 2000 to 2008, the Fugu government invested RMB 0.141 billion for alleviating poverty, including central and provincial fiscal poverty alleviation funds, local matching funds provided by prefecture and county, matching funds raised by functional departments and funds raised by the “masses.” The poor population was counted as 722,800 during that period, including those in absolute poverty with an annual income of less than RMB 625 and those with an income below RMB 865. The average annual per capita poverty reduction fund is RMB 195. For a detailed statistic synopsis of poverty and poverty alleviation in Fugu, see Lu et al. (2010).

<sup>135</sup> See *Pinkunxian fei zhudongshi tuopin zhaimao* (Poor Counties Passively Remove Their Epithets). Website of Beijingnews. <http://www.bjnews.com.cn/news/2012/03/23/189927.html> (accessed 5 October 2015).

challenge resides in fund raising, in particular in the rural areas.<sup>136</sup> As Mr. Tian explained:

Since the epithet of “poorest county” was removed in 2012, the anti-poverty funds transferred from the central and upper authorities have decreased badly. The prime source of funds is only from the county-wide economy in terms of tax revenues.<sup>137</sup>

By and large, the structural poverty and environmental destruction cause frequent village-enterprise/mine conflicts over land requisition, pollution and compensation to become major factors affecting social stability. Some farmers in the business operation areas demand that the enterprises provide money to restore the destroyed production and living conditions and to increase their income. Some landless farmers even obstruct business operations by blocking roads, cutting off power and collectively petitioning to government officials through the letters and visits system. A typical case was narrated by Mr. Qiu:

Before the “Double Hundred” project, one village of Tianjiazhai Town was an intense village-enterprise/mine conflict area. Due to the mass brawl and petition, the business interruption lasted for one year long until the enterprise invested RMB 10,000,000 in improving local farmers living and production conditions.<sup>138</sup>

Against this backdrop of such challenges posed and inspired by the framework of CNSC program, Fugu government established a strategic group in 2007 to design and implement the central policy programs reasonably well at local level. Following Heberer and Schubert’s theoretical approach to strategic groups, I examine what is strategic group in the context of Fugu locality and how Fugu state’s leading county and town officials constitute the strategic group to perform strategic agency and institutionalize CSR as a

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<sup>136</sup> See internal report: “*Womende zuji -Fuguxian shehuizhuyi xinnongcun jianshe jishi*” (Our Footprints: Record of Fugu’s CNSC Program Implementation), p. 19

<sup>137</sup> INT-15-201211.

<sup>138</sup> INT-17-201211.

redistribution mechanism to alleviate poverty and the dynamics of locality based policy innovation and implementation.

Yet, without doubt, the large-scale alleviation programs and redistribution mechanism function well because of the strong economy within the county. In other words, the huge wealth created by the coal mine owners and entrepreneurs form an indispensable economic precondition and foundation. For this reason, before studying the establishment of the strategic group, I examine the multifaceted and strategic roles of the local state, to show, in particular, how it boosts county-wide economic growth. This examination also provides an important perspective and context to explain the role of the local state in the poverty alleviation program.

### 5.3.1 Leading County and Town Cadres as a Strategic Group

According to Heberer and Schubert (2012), a strategic group refers to a group of persons that (a) have shared interests which they pursue strategically; (b) operate through formal organizations; (c) maintain mutual awareness and a collective identity, draw boundaries between themselves and other social constituencies and develop an esprit de corps; as well as (d) possess a common *habitus* related to the similar positions of their members in a given social field. In the case of the “Double Hundred” project in Fugu County, the strategic group is led by the “Core Group” (*lingdao banzi*) and comprised of local cadres within Fugu County across bureaucracies both horizontally and vertically.<sup>139</sup> Unlike the

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<sup>139</sup> In Fugu County, the “Core Group” can be roughly equated with the members of the County Party Standing Committee (*xian dangwei changwu weiyuanhui*). It consists of the following 11 cadres: The Party secretary; the mayor who is also the deputy Party secretary; the second deputy Party secretary in charge of the work of the Party Committee; the secretary of the Discipline Inspection Commission (*jiwei shuji*); the executive vice-mayor (*changwu fu xianzhang*); the vice-mayor responsible for industry or rural development; the commander of the local armed forces (*wuzhuang buzhang*); the director of the Propaganda Department of the Party Committee; the secretary for political-legal affairs (*zhengfa shuji*); the director of the Organization Department of the Party Committee; the director of the United Front Work Department of the Party Committee (*tongzhan buzhang*). See *Hexin lingdao* (the “Core Group” in Fugu County). Website of Fugu County Government. [http://www.fg.gov.cn/Category\\_276/Index.aspx](http://www.fg.gov.cn/Category_276/Index.aspx) (accessed 5 October 2015). For a description of the county “Core Group” classification, see Heberer and Schubert (2012).

party committee that is officially constituted of formal membership, the strategic group takes the form of an informal network opens to the cadre representatives cross various layers and departments. The members are, first and foremost, connected by common interests in terms of material goods or immaterial goods. Material benefits mainly refer to subsidies for the CNSC program from the upper authorities. To be specific, the “demonstration villages of CNSC” program enjoy considerable advantages in the distribution of scarce government funds and are the main destinations for the regular inspection teams sent down by the county, city and provincial governments (Schubert and Ahlers, 2012). Immaterial incentives include, most notably, promotion, social standing (Heberer and Schubert, 2012) and *mianzi*. For instance, the effective policy implementation by Fugu County government has enhanced the Party secretary through promotion to the vice mayor of a prefecture city of Shaanxi Province, as well as a Municipal Party Standing Committee member in charge of industrial development and national assets supervision and management. The former director of the poverty alleviation office who used to be responsible for the implementation of the “Double Hundred” project was awarded “the provincial excellent individual of poverty alleviation and development work” (*quansheng fupin kaifa gongzuo xianjin geren*). Due to his outstanding performance, he was transferred to the bureau of industrial economy in charge of the establishment of the “experimental zone of transformation and upgrading of the private economy” at Shaanxi Provincial level (*minying jingji zhuanxing shengji shiyanqu*). As for its social standing, it includes but is not limited to power, prestige, knowledge, respect and *rongguang* (lit. “glory”). Mr. Shao proudly explained and highlighted the connection between local cadres’ political achievements in terms of common interests and *rongguang*:

If the political achievements are outstanding, local cadres feel glorious. For example, when the vice mayor of Fugu County meets and talks with the vice-mayor of Jia County,<sup>140</sup> our mayor feels

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<sup>140</sup> Jia County is located in the northeast of Shaanxi Province. It is listed as the national poorest county, which was arranged by Yinlin Prefecture City to be aided by Shenmu County in 2012. See *Yulinshi renmin zhengfu guanyu jiaqiang nanbei xianqu duijie fupin de yijian* (Opinions Regarding Further Enhance the Pairing Aid between South-North Counties and Districts by Yulin Prefectural People’s Government), Website of Yulin Prefecture Government. <http://www.yl.gov.cn/site/1/html//zwgk/0/1/16/450.htm> (accessed

glorious and likely superior to the vice-mayor of Jia County because he works in Fugu County that is rich and has booming economy. He has a well-developed sense of superiority even though he does not put it straightforward that “My county is wealthier than yours.” Our common interest is to boost rural economy and improve the populace’s benefits that make us feel glorious when we go out to communicate with other cadres from outside of Fugu County. The leaders feel glorious and if upper authorities have recognized their achievements, their political prospects will be brilliant correspondingly.<sup>141</sup>

Power, as an important immaterial factor in terms of shared interests, plays a crucial role in structuring the relations between the policy implementation and political significance in the case study. In 2013, Fugu County was selected as the first provincial-level experimental zone of transformation and upgrading of the private economy. As Schubert and Ahlers (2012, p.76) suggest, “[e]xperimentation and modeling are important components of the Chinese policy process.” The provincial government selected Fugu as the model county of private industry transformation due to the decreasing resource endowments that boost the intra-county economy simply relying on raw material manufacturing, on the one hand. As a rule, the private corporations in Fugu County have been, during the last three decades, characterized by an extensive growth pattern with low technology and negative impacts on the environment. On the other hand, as the board of directors, financial consultant and mediator, the local state has played very important multifaceted and strategic roles in the booming rural economy. In the meantime, the local state has accumulated ample experiences in terms of the sustainable development of a circular economy and industrial upgrading from the economic practice. In addition, the successful policy implementation of CNSC (the “Fugu Model” of poverty alleviation highlighted by the central government) based on the concrete economic foundation also contributes to the final decision of the upper authorities.<sup>142</sup>

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5 October 2015).

<sup>141</sup> INT-09-201309.

<sup>142</sup> See *Fuguxian bei quedingwei shengji minying jingji zhuanxing shengji shiyanqu* (Fugu County is Confirmed as the Provincial Experimental Zone of Private Enterprise Economy Transformation and Upgrade). Website of Fugu County Government. <http://www.fg.gov.cn/Item/10631.aspx> (accessed 5 October 2015).

As a result, the experimental county has brought the local state considerable shared interests in relation to political autonomy, discretionary power and funds from the upper authorities, and enjoyed tailor-made policies from those upper authorities. In 2014, first and foremost, the Shaanxi Province issued the Opinions on the Piloting Counties of Fugu and Shenmu under Direct Provincial Administration (*shengguanxian*).<sup>143</sup> The prime criterion for the piloting counties of both Fugu and Shenmu is their powerful economic growth strength.<sup>144</sup> One of the objectives of the reform is to expand the county's autonomy in terms of becoming a city and promote county-wide economic growth and urbanization.<sup>145</sup> As Yang (2013) notes, the county cadres influence the policy reform through three channels, through which they intend to accelerate the county's development and increase the political influence of the county. The findings of Fugu officials' behavior and achievements match that outlined above.<sup>146</sup> To put it differently, first, the demonstration effect of poverty alleviation project (the Fugu Model) was recognized by the State Council in 2008; second, the successful implementation of the "Double Hundred" project influenced the provincial authorities on decision making in 2010, in which, Shaanxi Provincial Government launched a province-wide "Thousand Corporations Aid Thousand Villages" (*qian qi qian cun*) project that generally imitated

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<sup>143</sup> See *Shaanxisheng quanmian bushu shenfu liangxian shengzhiguanxian gaige shidian gongzuo* (Shaanxi Province Fully Deploys the Experimental Work of Reform of Direct Provincial Administration in Fugu and Shenmu Counties). Website of The Central People's Government of PRC. [http://www.gov.cn/xinwen/2014-06/20/content\\_2704808.htm](http://www.gov.cn/xinwen/2014-06/20/content_2704808.htm) (accessed 5 October 2015).

<sup>144</sup> Shenmu County is located adjacent to Fugu County, which is also a coal-endowed industrial county with a strong county-wide economy

<sup>145</sup> For example, Yang (2013) suggests that the provinces take on the direct administration of counties can solve some problems, including enhance the administrative efficiency by cutting off the bureaucratic layers, overcome the disadvantage of direct administration under prefecture cities and improve the harmonious urban-rural economic development.

<sup>146</sup> The county cadres adopt other two approaches pushing the policy reform, for examples, expressing their expectations of *shengguanxian* reform through media reports, internal meetings and inspections and indirect acts, such as disclosure of conflicts and problems so that clamps down on the decision makers. For detailed descriptions of county cadres' behavior, see Yang (2013)

Fugu's pairing schemes<sup>147</sup>; third, more importantly, the advanced economic position is a key contributor to the upper authorities' decisions on which county to choose as piloting county. Notably, Fugu County has entered the ranks of "China's top 100 counties" (*zhongguo bai qiang xian*) four times since 2010.<sup>148</sup> The main evaluation benchmark of GDP in terms of county-wide economy, as the precondition and economic foundation, guarantees that the upper authorities will attach considerable attention to Fugu and Shenmu counties with regards to the *shengguanxian* reform. To effectively implement the experimental zone project and promote institutional innovations the authorities have, without doubt, adopted a package of measures to grant Fugu's cadres more political autonomy and economic management power, associated with financial resources and policy supports.

1. Establish a Leading Small Group and Administrative Committee for transformation and upgrading of the private corporations that are under the direct administration of provincial authorities.<sup>149</sup>
2. Grant the private corporations considerable access to financial and land resources to guarantee the steady private economic growth, for example, the implementation of the fee waiver and electricity price subsidy policies, provision of discount loans to private enterprises.
3. Cultivate leading enterprises (*longtou qiye*) by improving the infrastructure, setting up platforms for fund raising, coordinating the financial institutions for credits and

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<sup>147</sup> However, according to Mr. Tian, the "Thousand Corporations Aid Thousand Villages" project is not effectively implemented because the majority of the corporations are production and commercially-oriented with little relationship to coal mines and because the pairing schemes match the enterprises and villages that are not in the business operation areas or in the owners' hometowns (INT-15-201211). For more detailed information of the project, see *shaanxi sheng qian qi qian cun fuzhu xingdong gongzuo shouce* (Action Handbook of Shaanxi's Thousand Corporations Aid Thousand Villages Project).

<sup>148</sup> The evaluation and ranking of the "China's top 100 counties" was formerly conducted by the State Statistical Bureau in 2004 and 2005 and a non-governmental research institute afterwards. For more detailed analysis of China's county-wide economy, see Ling (2003), Li and Zhu (2005).

<sup>149</sup> See *Fugu: genggao qidian zaichufa* (Fugu: Higher Starting Point for Taking Off). Website of People. <http://sn.people.com.cn/n/2014/0810/c226647-21940116.html> (accessed 5 October 2015).



loans. For example, under the coordination of Fugu County Government, a leading project of Group B has obtained RMB 0.6 billion loans and RMB 2.5 billion corporate bonds.

Based on the common interests in terms of material goods and immaterial factors, (i.e. career advancement, political influences and *rongguang*), and positional closeness (Heberer and Schubert, 2012), Fugu's cadres establish a strategic group to strengthen the internal coherence. Since the cadres are in similar positions in the administrative hierarchy of China's political system, on the one hand, they are in the similar situation and have to fulfill their task of implementing the CNSC program assigned by upper authorities. On the other hand, to generate social stability and regime legitimacy, they have to resolve the severe problems of income inequality induced by coal mining and conflicts between villages and corporations/mines (resistance by farmers) and satisfy the farmers' demands for improvements to their livelihoods. In addition to the positional closeness, the similar social status, life-style patterns (*habitus*) and organizational structure (i.e. the local Party branch) also contribute to fostering group coherence (Heberer and Schubert, 2012). Specifically, first, the members of the strategic group are aware of their similar social status, that is in terms of resources, influence, reputation, prestige and privileges. As Mr. Jiang put it:

The county [Fugu] is only this big, in other words, many people are, more or less, related by blood and marriage to build up the ties of kinship. Some others are connected as former army comrades, classmates and mahjong/cards friends. Thus we [the cadres] are bound to see much of each other (*taitou bu jian ditou jian*) and of course we know each other's strengths and capacity not only in work but also in daily social life.<sup>150</sup>

Second, they share similar life-style patterns that stem from positional closeness in local politics and the bureaucratic hierarchy not only through formal institutions, for instance, regular work meetings and attending Party schools (Heberer and Schubert, 2012), but also informal institutions. For example, according to my field observations, leading

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<sup>150</sup> INT-12-201210.

county cadres and their families live in the prefecture city, in particular the Party secretary and mayor, while town cadres usually live in the county and commute to the towns by car, and village cadres live in towns. In this way, the county and township cadres perceive that they share common life-style patterns and interests in terms of career advancement and personal connections with the upper levels.<sup>151</sup>

Third, the Party branch, as a formal political apparatus, played a salient role in ensuring the group unity of local cadres. The Communist Party led by the Party secretary unifies all the ideas (*tongyi sixiang*) of the local cadres regarding implementing policies and tasks (Heberer and Schubert, 2012). Moreover, in the case of Fugu County, the local state even establishes village-enterprise joint Party branches incorporating that of the corporations/mines and village. However, in addition to the formal institutions, informal factors also compel the party secretary to unite his subordinates. For instance, in my interviews, many county and town cadres highlight leadership skills, working capacity in terms of working experience, ability to solving problems and flexibility. Mr. Shao concluded that the institutions are united by the leaders with the cadres using “both carrot and stick” (*enwei bingshi*).<sup>152</sup> Mr. Qiu explained this in detail:

The leader should have a good personality to play an exemplary and leading role in all respects; working capacity, for example, speaking techniques, if the leader speaks with a stutter, the subordinates will not be convinced and the ability to addressing the clash between subordinates, maintaining the right direction of policy implementation. Another important indicator is the ability to managing cadres that can be not only rely on formal institutions but also the leader’s personal relations to the cadres, in other words, the leader has to care for the cadres’ lives, for instance, the leave of absence policy is rigid that the total days of leave are no more than seven days every month, but in practice, it is flexible otherwise the cadre will take a dislike to the leader because the cadre may take a leave of more than seven days this month and no days off next month. In this sense, the total leave days are balanced. Furthermore, the leader should also flexibly give cadres some treatments in terms of monetary rewards, for instance, cadres who are absent from duty get a

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<sup>151</sup> This echoes the findings of Schubert and Ahlers (2012); Heberer and Schubert (2012)

<sup>152</sup> INT-09-201309.

fine, while those who are on duty get an award. It is generally considered to be a very reasonable way of dispensing rewards and punishment because the leader should not only manage the cadres by assigning tasks without any extra treatment.<sup>153</sup>

As Heberer and Schubert (2012) suggest, a strategic group that consists of the county and township cadres is not a “homogenous group in terms of non-conflictive in-group behavior. In fact, much political strife and bickering resulting from diverging interests going on within the cadre bureaucracy.” The factional infighting and fierce political competition might cause the group members to work against each other. As Mr. Qiu put it helplessly:

Many cadres look forward to advancement so the competition is very fierce, because there are only two places for section chief level or deputy section chief level, but there are six or seven even eight candidates fighting for the places when the selection is made. All cadres want to be recommended by the leader as they all claim that they have worked in the position for many years already. However, the recommendation standard is not only based on performance evaluation, but also the important work the cadre has fulfilled. In addition, personal relations and impressions are considered as well. In other words, the cadre should have a good personality and has to do more work. If the cadre has a good personality and is accepted by other cadres, he will be accepted by the leader accordingly. In fact, the leader also listens to other cadres' opinions. Only when the cadre is accepted by other cadres and leader, will the cadres vote for and the leader recommends the cadre but finally it is still decided by the leaders (i.e. organizational department). The township cadres have little prospects of advancement due to the fierce competition and limited space of the strict hierarchical system. It depends on your own capacity besides the length of service. The capacity refers not only the work ability but also the personal relation with upper levels.<sup>154</sup>

Nevertheless, the positional closeness and shared *habitus* nurture collective identity that strengthens the internal group coherence (Heberer and Schubert, 2012). Specifically, the shared identity within the strategic group results from the common networks the cadres belong to, the members' shared experiences and similar life-style patterns, equal positions

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<sup>153</sup> INT-18-201309.

<sup>154</sup> INT-18-201309.

in China's politics and access to specific information in the locality. The common networks consist of formal and informal networks. The former is established through official occasions, such as, regular meetings and Party school trainings, and the mechanism that ties up the cadres works together in important Party and government organizations. The informal networks are embedded in informal institutions, for instance, social customs, norms and local knowledge. Mr. Qiu elaborated how local custom in terms of giving a gift or money (*suili*) and *mianzi* connect the local cadres closely:

The custom of giving a gift or money is based on mutual courtesy. One invitation hands out and means all cadres have to attend the event (i.e. an engagement ceremony, a wedding, a child's 12th birthday<sup>155</sup> or a funeral). Even though the cadre is not able to turn up in person, he has to give money in the range of RMB 300-500. If the cadre neither shows up nor gives money, it is perceived that the relation between the two cadres is not very good. The invitations connect the cadres in the group. If the cadre doesn't attend, he will be ostracized by other cadres and excluded from the group. Moreover, *mianzi* is another factor involved in the invitation custom. For instance, I am just getting to know a village cadre and then the cadre invites me. Because of *mianzi*, he invites a lot of people and if the town cadre presents, he feels having more *mianzi* in front of his guests. For this reason, I have spent more than RMB 3,000 out of my RMB 4,000 salary on the invitations this month.<sup>156</sup>

The access to specific policy and information ensures that the cadres within the strategic group perceive themselves to be distinct from other groups in terms of farmers, entrepreneurs so that strengthens their shared identity. For instance, Mr. Jiang explained the reason why the local state organized the policy dissemination in particular among the entrepreneurs as follows:

The private entrepreneurs in Fugu County generally have low educational levels. They don't know much about Party and state's policies or they lack the access to coal-related policy and information.

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<sup>155</sup> In Fugu County, a child's 12th birthday is a meaningful occasion that is associated with a special ceremony of "opening the lock" (*kaisuo*). The ceremony symbolizes that the child has grown up. For a detailed description of the local customs and norms, see *Fugu xianzhi*, p. 724.

<sup>156</sup> INT-18-201309.

Some corporations invest in building temples in villages to pray for favorable weather, but this is feudal superstition and against the policy of CNSC program. Thus, we (poverty alleviation officials) have to help them to get access to the correct information and policy, for example, the “three rural policy” (*sannong zhengce*).<sup>157</sup>

As a result, the county and township cadres within the strategic group are tightly bounded together by the shared identity. They develop and strengthen a group spirit and realize that they have to undertake cooperative action to implement the CNSC program. The goal-oriented strategic cooperation is reinforced by local cadres' institutional environment and a collective identity. By implementing the CNSC program cooperatively, the cadres gain more benefits resulted from positive evaluations, maintain and expand their common interests in terms of promotions, establishing experimental zones, piloting political reform of the county (*shengguanxian*) and influence on policy making (i.e. the “Thousand Corporations Aid Thousand Villages” rural development project).

### **5.3.2 Strategic Agency in the Implementation of the “Double Hundred” Project**

Strategic agency and a collective identity are the major features of strategic groups. Strategic agency refers to “the gathering of strategic information and the commitment to strategic analyses, strategic planning, and strategic (policy) implementation as much as continuous organizational learning” (Heberer and Schubert, 2012). County and township officials engage in strategic agency to effectively implement the CNSC program in order to maintain their relative political autonomy and discretionary power from upper authorities. However, the outcomes of policy implementation (i.e. strategic agency) are determined by (a) external factors in terms of economic development, resource endowment (i.e. financial and human capitals, and, in the case, coal resources); various project monitoring and evaluation systems in terms of inspection from upper levels and cadre performance evaluation; (b) incentive mechanisms consist of extrinsic incentives,

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<sup>157</sup> INT-12-201210.

such as material goods in terms of remuneration and rewards, and immaterial goods in terms of career advancement, social status, prestige, respect, *mianzi*; intrinsic motivation including personal background, experiences and values, etc.; (c) discretionary power in terms of “organized anarchy” (Heberer and Schubert 2012, p. 239). The extrinsic and intrinsic motivations are identical for all or many counties in contemporary rural China (Heberer and Schubert 2012, p. 240), and given the assumption that other external factors are similar with regard to economic development, financial and fiscal resources and institutional constraints, it argues that examining the discretionary power in terms of leeway and autonomy in policy process is necessary to explain the different patterns of strategic agency.

In Fugu County, strategic agency results in effective implementation of the CNSC program by virtue of the success of the “Double Hundred” project. The 20-character guideline (see Chapter 1) encourages, in line with all such general policy statements, broad interpretations in response to local conditions. In this sense, local governments are required to make specific blueprints to promote *local* rural development within the central framework. To be specific, Fugu County officials framed a “Comprehensive Plan for the CNSC Program (2007-2012)” that incorporates 20 town/township plans and 102 village plans, and a “Construction Plan for Four Agricultural Zones.”<sup>158</sup> County and township governments are the actors of implementing the specific projects in accordance with the blueprint and local conditions. In the case of Fugu County, for instance, various projects including infrastructure construction (i.e. roads, schools, electric grid and drinking water), relocation projects, and modernization of agricultural production (i.e. greenhouse vegetable planting, agricultural products processing and livestock breeding) are carried out. The local state enjoys considerable leeway and autonomy to carry out the program. For instance, one model village (*yangban cun*) and 12 prefectural standard demonstration villages (*shifan cun*) are established by the Fugu County

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<sup>158</sup> See internal report, “*Womende zuji-Fugu xian shehui zhuyi xinnongcun jianshe jishi*” (Our Footprints: Record of Fugu’s CNSC Program Implementation), p.47.

government.<sup>159</sup> These model/demonstration villages are decided by the leading cadres in charge of the program and enjoy considerable advantages in resource allocation in terms of government funds and political importance attached by upper inspections. For instance, in 2006, the Bureau of Finance appropriated RMB 4 million in earmarked funds to develop the piloting/demonstration villages in order to generate four models.<sup>160</sup>

Concerning the implementation funds, Fugu County Government finances the CNSC program with transfer payments or earmarked funds provided by higher levels of government (Schubert and Ahlers, 2012), and is thus required to provide matching funds (*peitao zijin*) for the earmarked funds. For this reason, the local state has the obligation of raising matching funds. As argued in Section 5.3, the county and township governments encounter fiscal constraints due to the uneven economic development and widening regional inequality and disparity induced by coal mining in Fugu County. However, in return, the fiscal constraints have given Fugu County Government some financial leeway and opportunities to innovate its institutions. In the meantime, the social instability results from frequent village-enterprise/mine conflicts over land requisition, pollution and compensation imposes severe pressure on local cadres not only the regime legitimacy, but also the local cadres' performance evaluations. Mr. Qiu described how the resistance by farmers, in other words, the petition system, has imposed huge pressure on the local cadres:

When a farmer appeals to county, city and provincial authorities to complain, the Complaints Bureau (*xinfang ju*) from upper level just telephones us to bring the farmer back, issuing an eight-character instruction: "make them return, address the issue" (*ren ling huiqu, shi yao jiejie*). The pressure is consequently imposed on us. Furthermore, the farmers' petitions are among the defined indicators to assess the local cadres' performance in the end of every year. Thus the grassroots cadres really have big pressure from both upper levels and local populace. Without the grassroots

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<sup>159</sup> These terms may be interchangeable. See Schubert and Ahlers, 2012.

<sup>160</sup> See internal report, "Womende zuji-Fugu xian shehui zhuyi xinnongcun jianshe jishi" (Our Footprints: Record of Fugu's CNSC Program Implementation), p.7.

cadres, the populace would rise up.<sup>161</sup>

This concern is echoed by Mrs. Zhou, the head of Wujiazhuang Town.<sup>162</sup> Thus the local state has to take actions to respond to pressures from above (i.e. performance evaluation that may lead to demotion or dismissal) and to maintain regime legitimacy. In this context, CSR is adopted by the local officials to incorporate coal mines and coal-related corporations to initiate the “Double Hundred” project which is under the framework of the CNSC program. Through the effective implementation of “Double Hundred” project, first and foremost, the local state solves the trouble of shortage of matching funds of the CNSC program, associated with maintaining social stability at local level, and political significance recognized by upper levels in respect to experimental zone of private economic transformation and upgrading, piloting county of *shengguanxian* system and career advancement.

I argue that the local cadres, as a strategic group, fully play a role as a strategic agency to formulate collective aims, take cooperative actions in carrying out the “Double Hundred” project. To examine the strategic agency in the case study of implementation of “Double Hundred” project, I show how the organizational structure of the project that involves government departments and coordinating body is established, how the roles of local cadres function as strategic group, how the project is designed and launched in chronological sequence and how the strategic agency constituted and in the section. The “Double Hundred” project is coordinated by Fugu’s Leading Small Group of Rural Work (*Fuguxian nongcun gongzuo lingdao xiaozu*) under Fugu’s Party Department of Rural Work (*Fugu xianwei nongcun gongzuobu*). 28 project-related departments and organs are coordinated by the Leading Small Group of Rural Work that integrates all the information concerning the “Double Hundred” project by investigating the details and links of project implementation, and coordinates the cooperation of all government

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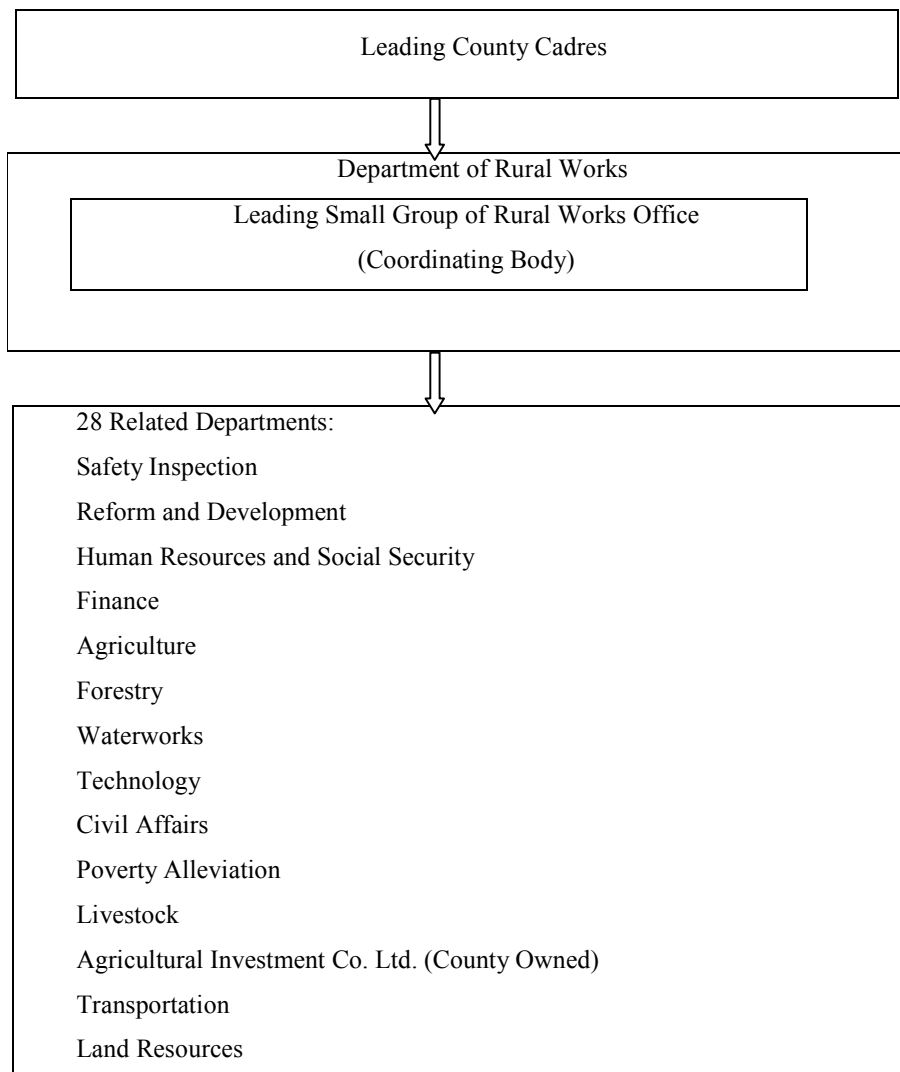
<sup>161</sup> INT-18-201309.

<sup>162</sup> INT-22-201211.



departments and organs in case there are overlapping responsibilities arise during the project implementation (Schubert and Ahlers 2012, p. 72). As argued earlier, the leading county cadres include 11 members of Fugu's Party Standing Committee who are the most influential members in the strategic group. The Leading Small Group is led by the mayor and composed of 28 project-related department heads and many town leading cadres within Fugu County across bureaucracies both horizontally and vertically (see Figure 5.1). They together are the main operators in the strategic group implementing the “Double Hundred” project.

**Figure 5.1: Organizational Structure of the “Double Hundred” Project: Government Departments and Coordinating Body**



Audit
Health
Family Planning
Statistics
Industrial Economy
Education
Energy
Radio and TV
Supply and Marketing Cooperative
Electrical Power
Telecommunications
Youth League Committee
Women's Federation
Disabled Federation

Source: Own compilation

The various roles and functions of the actors in terms of county and town cadres and entrepreneurs in the implementation of the “Double Hundred” project are stipulated distinctly by the scheme of “Double Hundred” project (see Table 5.1). Among the members, as the top leader of the strategic group, the role of the Party secretary attracts the most attention. According to Mr. Shao, between 2006 and 2009, the Party secretary united the members by stressing the importance of the “Double Hundred” project, and the mayor took responsibilities for specific work, for example, when he carried out inspections in villages, he asked the corporations how much money they had given, and pushed those that had not done so. When the mayor took up the position of Party secretary in 2009, he did not shift the specific work to the mayor but was still in charge of the “Double Hundred” project<sup>163</sup>. The Party secretary’s dedication to the project decision-making and implementation explains the importance of the role, why the project has achieved positive outcomes and his personal career advancement consequently. In this sense, the Party secretary “does not only figure as the chief designer of local policies, but also has to ensure group cohesion and the compliance of all members to follow the

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<sup>163</sup> INT-09-201309.

leading core's decision'' (Heberer and Schubert, 2012, p. 233). Although the responsibilities among the actors may overlap, for example, the heads of “assist the town” (*baozhen*) government departments, the public institutions and town cadres concerning carrying out projects, they may not bring negative effect on the project implementation but, to some degree, reinforce the outcomes of fund raising from the coal mines/corporations.

**Table 5.1: Fugu’s Actors and Functions of “Double Hundred” Project Compared**

The role of actors specified in Fugu’s “Double Hundred” project	The responsibility of actors specified in Fugu’s “Double Hundred” project
1. Leading county cadres-General initiator	1. To mobilize and push the public institutions and enterprises to make contributions to the pairing villages in terms of human power and funds;  To organize the public institutions and enterprises to tie up long-term and stable pairing relationship with villages.
2. Leading town cadres (Party secretaries and heads)- Project principal responsible persons	2. To design the pairing scheme and blueprint of town “Construction of a New Socialist Countryside” program and implement “Double Hundred” project;  To carry out the projects on the ground, ensure and follow up project funds, coordinate the relationship between “assist town” government departments, public institutions and enterprises, evaluate and manage the village-stationed cadres designate by public institutions;  To contact agriculture departments and project management offices for technical assistance.
3. Leading Small Group of Rural Work-General coordinator and researcher	3. To make decisions on selection of specific project plans and projects submitted by township governments for funding, final allocation of funds, and the participation and coordination of government agencies;  To study the details of implementation of

	<p>“Double Hundred” project, refine the orders from Fugu County Government;</p> <p>To formulate monthly, quarterly and yearly reports and evaluation systems, push the project progress.</p>
4. “Assist the Town” government department leaders-General assistant	4. To assist the county level cadres in carrying out specific tasks by monitoring public institutions and enterprises, including design construction plan, promote infrastructure construction, develop a characteristic industry and labor economy.
5. Heads of public institutions- Project specific responsible persons (fund raiser)	<p>5. To be paired with aided villages and push the coal mine/corporations to send funds to aided villages;</p> <p>To carry out projects by investigating in villages, introducing technology and generating incomes.</p>
6. Agriculture-relevant departments-Technical assistance	6. To provide technical assistance, ensure good use of funds, eliminate funds abuse.
7. Coal mines and coal related corporations-Project fund pillar	<p>7. To timely send funds in accordance with the pairing scheme and poverty alleviation plan;</p> <p>To help villagers to develop third industry, promote labor economy by employing rural surplus labor force.</p>
8. News media-Watchdog	8. To publicize the good performance of public institutions, enterprises and cadres, expose any poor project implementation.

Source: Own compilation

Once the coordinating body is established and project-related government departments are confirmed, the project design and implementation are conducted in a chronological sense. First, in 2006, the county Party secretary and mayor led the heads of relevant departments to repeatedly and extensively conduct investigation and research in villages and enterprises. Their findings included: (1) The core issue of the conflicts between mines/corporations and villages that result in farmers' collective petitions to authorities is

the farmers in the business operation areas demand the corporations/mines to restore the destroyed production and living conditions and to increase their income. (2) The institutional foundation for guiding enterprises to engage in poverty alleviation existed in Fugu County since 1995. More than 300 industrial enterprises and 100 coal-related enterprises have conducted aid projects in the business operating areas, including road construction, drinking water supply and power grid renovation. Some entrepreneurs have engaged in poverty alleviation practice in their hometown villages, including infrastructure construction; some made donations to charity or poor students; some give money to help those in need who approach them. The practice in 1995-2006 was characterized by spontaneous and voluntary giving. (3) To a large extent, mines/corporations are willing to improve the local production and living conditions because they also enjoy the considerable advantages of the program in terms of smooth and fast business operations. (4) More importantly, because Fugu's corporations gained strength to develop into conglomerates, most of them have the economic foundation to engage in poverty reduction practice.<sup>164</sup>

Second, in March 2007, building on the principle of “government guides actively, enterprises participate voluntarily” (*zhengfu jiji yindao, qiye ziyuan canyu*), Fugu County Government issued the “Arrangements by Fugu County Government Regarding the Implementation of the ‘Double Hundred’ Project to Promote CNSC” that determined that 155 functional departments and 176 mines and coal-related enterprises (accounting for 33% of all mines and corporations in Fugu County) be paired with 165 villages (accounting for 42.5% of all administrative villages in the county), seven strong economic towns<sup>165</sup> located in middle and west supported seven pure agricultural towns

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<sup>164</sup> See internal report, *Womende zuji-Fugu Xian shehui zhuyi xinnongcun jianshe jishi* (Our Footprints: Record of Fugu's CNSC Program Implementation).

<sup>165</sup> In 2011, according to the town planning, the number of town-level jurisdictions changed from 12 towns and eight townships to 15 towns in Fugu County. See *Shaanxisheng fabu chexiangbingzhen ji bufen xiangzhen xingzheng quhua tiaozheng gonggao* (The Announcement of Dismantling Townships and Merging Towns Issued by Shaanxi Province). Website of The Central People's Government of PRC. [http://www.gov.cn/gzdt/2011-07/07/content\\_1901351.htm](http://www.gov.cn/gzdt/2011-07/07/content_1901351.htm) (accessed 5 October 2015). Among the 15 towns, there are seven pure agricultural towns having no coal resource or industrial base and eight economic towns extracting revenues from coal-led industry.

located in east and south (see Table 5.2). The pairing institutions functioned on the basis of entrepreneurs' wishes, some of them wished to help their hometown villages; some wished to support the villages in their business operation areas; some wished to aid the villages that had connection with them. For those entrepreneurs who didn't have specific desires, the government made decisions to pair villages with them.

Meanwhile, the local state arranged 20 county-level leaders and 20 county-level functional departments to assist 20 towns in implementing the "Double Hundred" project and connect with 40 villages. It also determined 34 county-level leaders, 34 functional departments, 34 working groups and 53 enterprises and mines that must assist 34 key villages in CNSC program. Shortly after the policy was formulated, the Leading Small Group of Rural Work deliberately organized a mobilizing meeting attended by all county and town leaders, and heads of project-related functional departments, villages receiving aid, and listed enterprises were involved. The county government's main purpose of convening the meeting was to mobilize entrepreneurs to engage in the implementation of the "Double Hundred" project in a dynamic environment. The mobilizing meeting was held once every year, under the rubric of rural work. The following narrative by Mr. Shao presents how government agencies and enterprises interacted at the mobilizing meeting:

The meeting is held at beginning of every year. First, the Party secretary and mayor give speeches. After that, the functional departments in charge and villages describe the project plan this year, then the enterprises and mines state clearly their stand. When the government leaders encourage the enterprises, they say, "The profits of your business are so high. Even though you give much money out, so what?" Once one enterprise or mine offers RMB 500,000, the others just follow unless your mine has encountered some problems of running down. In this case, you can give less, something like RMB 300,000. The declaration of donation amount is made one by one, so everyone can hear how much others give. Because of *mianzi*, you will feel ashamed if you give less than others.<sup>166</sup>

Third, in April 2008, Fugu County Government reissued the "Arrangements by Fugu

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<sup>166</sup> INT-08-201211.

County Government Regarding the Continuous Implementation of ‘Double Hundred’ Project to Promote CNSC,” based on the lessons and experiences learnt in 2007. It determined that 158 functional departments and 173 enterprises and mines should aid 162 villages (see Table 5.2). The number of economic towns required to support pure agricultural towns fell from seven to six. Since the infrastructure constructions were nearly completed in 2007, the focus of the CNSC program shifted to agricultural industrialization in 2008. Table 5.2 compares the funds contributed by the coal mines and coal-related corporations, and the engagement in the “Double Hundred” project between 2007 and 2010. Apparently, the mines/corporations have made overwhelming contributions to solving the shortage of funds for CNSC program because the funds made available by corporations/mines are 28.4 fold of the earmarked funds appropriated by the Bureau of Finance between 2006 and 2008.<sup>167</sup>

**Table 5.2: Fugu’s “Double Hundred” Project Funds Raised and Engagement Compared (2007-10) (Billion RMB)**

Year	Project Funds Raised	Earmarked Funds Appropriated	Projects Completed	Number of Enterprises/Mines Engaged	Number of Public Institutions Engaged	Villages Involved
2007	0.161	0.012	261	176	155	165
2008	0.180		208	173	158	162
2009	0.184		200			
2010	0.310		199			
Total	0.835 <sup>168</sup>		868			

Source: Own compilation

<sup>167</sup> According to the internal report, the earmarked funds appropriated by the Bureau of Finance are calculated for the period 2006 to 2008 (RMB 12 million), while the funds collected by corporations/mines are from the period 2007-2008 (RMB 341 million).

<sup>168</sup> The total Project Funds I calculated are based on the breakdown of funds. It is different from the figure in the internal report issued by Fugu County Government that is RMB 0.909 billion.

### **5.3.3 The Consolidation of the Strategic Group: Local Private Entrepreneurs Incorporated in the Strategic Group**

In virtue of the combination of open and informal traits, the leading county and town cadres have successfully incorporated the local private entrepreneurs in the strategic group. In the “Double Hundred” project, the local cadres have created a formal institutional environment of participation in the project implementation. The local officials interact with and incorporate local coal miners/entrepreneurs vividly through a package of measures. In more detail, there are quite a few measures that equally involve the local cadres and entrepreneurs. First, county leading cadres actively and publicly propagate the “Double Hundred” project. Second, an incentive system is introduced, whereby the corporations that make great contributions in the “Double Hundred” project are given priority to resource allocation. Third, local cadres advise entrepreneurs to aid the poor by describing the poor people’s living conditions and recall the hardship they themselves experienced prior to establishing their corporations. This plays on the moral duty of the entrepreneurs to be true to their roots and thus to cultivate their *mianzi*. Fourth, aside from these measures, the local state creates a favorable environment to encourage local enterprises to take part in the project, including media reports and exposures. For the entrepreneurs who had donated a large amount of money and made notable contributions to the “Double Hundred” project and other social development programs, the local media, including newspaper and TV station highlighted their engagement in the poverty alleviation practice; conversely, poor project implementations are exposed as negative examples. The local state creates several exemplary entrepreneurial models by holding commendation meetings calling paragon entrepreneurs wearing red ribbons and flowers onto the stage and presenting them with awards. In 2008, 48 coal corporations received commendations from the local state for their considerable contributions in terms donations to the project. In the same year, to promote the coal boss's political and social status, the local state even employed four coal bosses who had paid more than RMB 10 million taxes in the previous year, associated with notable donation in the rural



development projects, to work as assistants to the county mayor. According to the director of the Organization Department of the Party Committee, these four county mayor assistants continued working in their past functions (*butuochan*), while being seconded to the county government and entitled to take part in the process of economic development decision making. However, they were removed from office after eight months due to the strong force of public opinion.<sup>169</sup> On top of these, appointing the coal mine owners or managers to work as village cadres is quite common in this county. For instance, one mine owner as well as manager was appointed by the town government as a village's Party secretary.<sup>170</sup>

However, the informal institutions (involving, broadly, networks, norms, customs and personal relations in the form of *guanxi*) that are deeply intertwined further prove that they not only connect the local cadres closely but also contribute to the effective implementation of the "Double Hundred" project. For instance, the pairing meeting is supposed to be a formal institution created by the local state to encourage the local entrepreneurs to engage in the fund raising practice. However, the informal social networks and other relations lead to competition and emulation due to peer pressure and the *mianzi* "ideology." As Mr. Cao put it:

The pairing meeting affects a lot on the entrepreneurs because it creates big pressure for others to follow and donate. Some complain that they are forced to donate or aid the poor villages or otherwise lose *mianzi* in front of other entrepreneurs.<sup>171</sup>

In addition to that, local cadres are encouraged to befriend entrepreneurs. Building on friendship, the cadres are very likely to convince the coal mine/corporations to engage in the "Double Hundred" project in respect of fund raising. Mr. Shao, the senior officer of

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<sup>169</sup> See *Shaanxi fugu xianwei lianye jizhai meilaoban hongding* (Fugu County Committee Takes Off the Red Crown of Meilaoban Overnight). Website of People. <http://politics.people.com.cn/GB/14562/8759256.html> (accessed 5 October 2015).

<sup>170</sup> A detailed explanation will be found in Chapter Six.

<sup>171</sup> INT-05-201211.

the Rural Work Department as well as one of the members of Leading Small Group, is responsible for raising funds for his village from the coal mines/corporations. He explained how *guanxi* functions in the process of fund raising:

The heads of government departments have personal relations with owners, some are hometown fellows, some are classmates. I come from a village in the east that is a purely agricultural area without coal mines. I have a classmate who owns a coal mine in another town and I let him assist my village for two years by means of the relationship of classmate. In that year, the owner and town/village cadres were convened by me in order to persuade the owner to give money. He was not born in our village, but he spent his childhood in my hometown, a production team at that time, so he still has special feelings for the village. Other corporations that were arranged to pair with my village are reluctant to send funds, but I have no solutions because I don't have personal relations with the owners. In another case, it is about networking. One corporation located in Xinmin Town funds my village through Xinmin Town's Party secretary. I invited the owner and the Party secretary to a meal and finally he agreed to aid my village. Without the Party secretary, I was unable to invite him and make things done.<sup>172</sup>

Moreover, the local state has formulated a favorable ideological rationale with which to promote the implementation of the poverty alleviation program. The ideological tenor is:

1. Local consensus is reached in the locality that "coal resources are owned by the state, and the corporations' business is legal. Once the masses experience difficulties, the corporations should help them."
2. Positive ideas promoted by Party organizations and cadres involves maxims like "when everyone helps each other, there'll be no poor people" (*renren bang renren, shishang wu qiongren*).
3. The principle of "the government helps corporations to solve their difficulties in business, and enterprises help government to share worries in social development."
4. The win-win notion of "promoting corporations' and farmers' common development."

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<sup>172</sup> INT-09-201309.

The formal and informal institutional factors enriched with such ideological reasoning and practices, join together to undergird the strategic agency of local cadres in project implementation and in particular fund raising. The mines/corporations are officially encouraged to send funds to the “Double Hundred” project voluntarily by pairing with poor villages. In this sense, the local cadres command a discretionary power to persuade the coal mine owners/entrepreneurs to ensure contributions are made, but mainly through informal networks. Furthermore, the formal and informal institutions have established the symbiotic relations between villages and mines/corporations; locate state and corporations in Fugu County.

#### **5.3.4 The Internal Evaluation System**

As the formal institutional constraint, the internal evaluation system also plays an important role in ensuring the effective implementation of the “Double Hundred” project. The assessment system of towns and departments is established and conducted by the Leading Small Group of Rural Works. The assessment of project implementation and management is conducted quarterly in order to, on a regular basis, inspect and control the progress of project implementation. The comprehensive evaluations are conducted at the end of each year. The results of quarterly assessments are considered in the annual comprehensive evaluation system. As Mr. Shao recounts, according to the final comprehensive evaluation results, towns and departments that perform the project implementation relatively well used to be rewarded RMB 10,000-20,000 but nowadays they receive “spiritual” encouragement like metal plaques, because the practice of giving material rewards has been abolished by upper levels.<sup>173</sup> The career advancement of the Party secretary and the director of the poverty alleviation office (Section 5.3.1) is an exemplary demonstration of the cadres’ overall excellent performance. In contrast, for those towns and departments that stand at the bottom of the final list, the internal

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<sup>173</sup> INT-09-201309.

evaluation system imposes pressure on them because the public list within all government agencies makes the cadres lose *mianzi* and their departments or towns may be punished by future fund reductions (Schubert and Ahlers 2012, p. 83). Without doubt, the incentives and punishments of the internal evaluation system unite the local cadres to take strategic cooperative actions to fulfill the project and expand their common interests.

### **5.3.5 CSR as Strategic Agency and as a Redistribution Mechanism**

The strategic group in Fugu County adopts administrative and economic measures to transfer resources from the corporate sector to villages in order to compensate for poverty and loss of livelihood under the heading of CSR schemes. In fact, apart from the implementation of the “Double Hundred” project that is the focus of this study, the local state has formulated a package of redistribution mechanisms to minimize the downsides induced by coal mining:

1. In December 2006, the local state issued the Guidelines on Setting up the Compensatory Mechanism for Coal Resources Exploitation and Conflict Resolution to levy a compensation fund at RMB 3 per ton for state-owned, township and village coal mines, and RMB 1 per ton for coal mines supporting large coal fueled electricity plants and chemical projects. 70% of the compensation fund is used to compensate the farmers and villages that are immediately affected by coal mining, in other words, the county government collects the compensation fund and distributes it to towns, then the town governments transfer it to the villages and finally the village cadres hand it over to the farmers.<sup>174</sup> 30% of the compensation fund is used to subsidize the farmers who are indirectly affected and do not have coal mines in their area. It is called a coal subsidy for the winter season. The local state accumulated RMB 0.36 billion between 2006 and 2010.
2. In September 2008, Fugu County Government issued the Implementation Measures

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<sup>174</sup> INT-170201211.

for the Land Collapsed Areas on Ecological Rehabilitation and Relocation Projects. The relocation project is embedded in the CNSC program by the local state. The coal mines and enterprises have invested RMB 0.75 billion in the relocation project, covering over 8,000 farmers in 60 villages who are affected immediately by coal mining.

3. Fugu's government also persuades the private entrepreneurs and their enterprises to engage in social programs, expanding them to the whole county. In 2010, 57 coal business entrepreneurs and the 77 coal mines they own donated RMB 1.28 billion to build a high-grade middle school, one vocational school, one primary school and one hospital located in the county so that all the residents in the county could benefit from the educational and medical facilities. Shortly afterwards, the government organized other entrepreneurs involved in coal chemistry and the magnesium industry to contribute RMB 0.276 billion to set up one education foundation and one serious illness aid foundation, in which the government inputs RMB 30,000,000 in the two respective foundations.<sup>175</sup>

These redistribution mechanisms are seen as the strategic agency displayed by the local state not only serve to compensate for poverty and loss of livelihood, but also bring about positive outcomes of local regime and expand their common interests in terms of promotions, experimental zone, piloting county of political reform (*shengguanxian*) and influence on policy making (i.e. the "Thousand Corporations Aid Thousand Villages" project).

## 5.4 Summary

First, this chapter described the differences and features among the Party Committee

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<sup>175</sup> See *Jiaoyu jijin* (Education and Health Care: Education Foundation). Website of Fugu County Government. <http://www.fg.gov.cn/Item/6409.aspx> (accessed 5 October 2015) and *Dabing jiuzhu jijin* (Education and Health Care: Serious Illness Aid Foundation). Website of Fugu County Government. <http://www.fg.gov.cn/Item/6399.aspx> (accessed 5 October 2015).

leadership small group, the state/local people's government and strategic group in the policy making and implementation process. Compared to the very formal CCP and the state, the strategic group served as the informal coordination institution, which is an open and informal network consisting of influential people at various levels who share common interests. However, the Party, the state and the strategic group share overlapping lines of authority and Party officials play dual roles both in the Party and government organs.

The chapter then examined how the leading county and town cadres in Fugu County establish a strategic group in order to effectively implement CNSC. It shows that the strategic group is led by the "Core Group" (*lingdao banzi*) and comprised of local cadres within Fugu County across bureaucracies both horizontally and vertically through common interests in terms of material goods or immaterial goods. Material goods include scarce government funds distributed from upper authorities after regular inspections. Immaterial incentives include promotion, social standing, *mianzi* and *rongguang* and so on. The strategic group plays a systemic strategic agency to implement CNSC by designing a "Double Hundred" project in line with CNSC. Furthermore, the strategic group has successfully incorporated the local private entrepreneurs in the project implementation through formal and informal mechanisms. As a consequence, the local coal mine owners/entrepreneurs have become part of the strategic group.

Finally, the chapter demonstrated that CSR is institutionalized by the strategic group as a redistribution mechanism to compensate for poverty and loss of livelihood. The powerful mechanism as part of the strategic agency played an important role in the effective implementation of CNSC.

## **Chapter 6. Case Studies of Xinmin Town and Wujiazhuang Town**

### **6.1 Preamble**

Town governments are the major implementers of the “Double Hundred” project. This chapter investigates two cases that display diverging patterns of strategic agency in the implementation of the “Double Hundred” project at the town level. The case of Xinmin Town represents approaches in which miners are voluntarily compelled to adopt various mechanisms in order to deal with severe conflicts between enterprises/mines and villages in business operation areas, while the case of Wujiazhuang Town demonstrates the countermeasures undertaken in an entrepreneur’s hometown that is a purely agricultural village without a coal endowment. Both case studies suggest that informal institutional factors (i.e. local customs, personal relations, prestige, skills, knowledge, affinity and *mianzi*) are manifest within the broader framework formal institutional arrangements in terms of fund raising, redistribution and mediation mechanisms during the implementation of the rural development project. Nevertheless, Wujiazhuang Town has used much more informal institutions to raise funds since the town cadres encounter severe fiscal constraints, rather than relying on financial appropriation from upper authority and pairing enterprises.

The case studies are organized in three parts. First, I describe the socioeconomic situation of Ximin Town and explore how local town cadres create diverging patterns of strategic agency by examining the mechanisms of fund raising, redistribution and mediation. Second, I present the case of Wujiazhuang Town in a similar format with Xinmin Town. Third, some commonalities and differences between the two cases are compared.

### **6.2 The Case of Xinmin Town**

### 6.2.1 Field Setting

Xinmin Town is situated in the west of Fugu County and is home to more than 12,000 residents in 3,539 households and a 16,000-strong “floating” population. It covers 204 square kilometers and manages 11 administrative villages and 95 natural villages. In contrast with other parts of Fugu County, Xinmin Town owns abundant coal resources and is referred to as the “western gateway” of Fugu’s economy and one of the most dynamic areas in northern Shaanxi’s social and economical developments during the last decade. The 51 enterprises in Xinmin Town include 21 restructured coal mines, three industrial parks, eight metal magnesium factories and 19 other type of enterprises. The town accounts for 96% of the county’s revenues.<sup>176</sup>

With its booming local economy, Xinmin Town has become one of the most attractive towns in northern Shaanxi. It was given the status awards of “National Key Town” (*quanguo zhongdian zhen*),<sup>177</sup> “Shaanxi Provincial Key Town,” and “Yulin Prefectural Key Demonstration Town.” Nevertheless, the rapid and massive coal mining has induced profound social and environmental problems that are illustrated in Section 5.3. As such dissatisfactions intensify, social order has become more problematic and the danger increases that local cadres seek to divert discontent by creating a redistribution system through the “Double Hundred” project.

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<sup>176</sup> A statistical survey shows that in 2013, the gross industrial output value arrived at RMB 9.99 billion, investment in the fixed assets RMB 1.24 billion and tax revenue 0.29 billion. Farmers’ per capita net income in the town reached RMB 19,950. See *Danwei jianjie* (An Overview of Xinmin Town). Website of Fugu County Government. [http://www.fg.gov.cn/Category\\_334/Index.aspx](http://www.fg.gov.cn/Category_334/Index.aspx) (accessed 5 October 2015).

<sup>177</sup> *National Key Town* status is the heart of local county economy and indicates the significance of economic development, planning management and technology innovation. *Zhufang chengxian jianshebu deng bumen guanyu gongbu quanguo zhongdianzhen mingdan de tongzhi* (The “List of National Key Towns”) was published jointly by seven ministries on July 21, 2014, including the Ministry of Housing and Urban-Rural Development of the People’s Republic of China, National Development and Reform Commission, Ministry of Finance, Ministry of Land and Resources, Ministry of Agriculture, Ministry of Civil Affairs, Ministry of Science and Technology. See Notice on the List of National Key Towns. Website of Ministry of Housing and Urban-Rural Development of PRC. [http://www.mohurd.gov.cn/zcfg/jsbwj\\_0/jsbwjczghyjs/201407/t20140731\\_218612.html](http://www.mohurd.gov.cn/zcfg/jsbwj_0/jsbwjczghyjs/201407/t20140731_218612.html) (accessed 5 October 2015).



### 6.2.2 Fund Raising Mechanisms

As the major implementers of the “Double Hundred” project, town governments have listed tasks to fulfill. One of the most important and urgent issues is to push the mines/corporations to send funds. According to the pairing schemes formulated by county government, towns with mines and coal-related corporations are more likely to have access to getting funds. A large number of mines/corporations aid local villages in the business operation areas because they have to respond to the social and economic pressures exerted by the farmers (see Chapter 5). In this sense, they are forced to pair with local villages to improve their living and production conditions that are beneficial to corporations manufacturing as well. However, besides the formal financial resources provided by mines/corporations in terms of pairing agreements, informal networks (i.e. personal relations) are embedded in town and upper governments. Mr. Qiu elaborated how personal relations (*guanxi*) impact on the outcome of project implementation with regard to fund raising:

If you have close relationship with the Poverty Alleviation Office, you will get more funds for poverty reduction. In theory, there is specific standard of poverty alleviation funds allocating to each town, but it's also possible to allocate more funds (i.e. RMB 100,000) to your town. For example, our Party secretary used to keep regular contacts with the Poverty Alleviation Office, inviting the leaders to meals and having more communications, which means the Poverty Alleviation Office is expected to take more care of our town when allocating funds. In the end, the relations between the Poverty Alleviation Office and our town become closer.<sup>178</sup>

As argued in Chapter 4, town governments not only get hold of the power of approval and resource allocation, but also the coordinating forces of land circulation and compensation. The official services of town governments have guaranteed mines/corporations to maximize profits, and in return, the personal relations between town cadres and mine owners/entrepreneurs facilitate fund raising at grassroots level. As Mr. Qiu put it:

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<sup>178</sup> INT-18-201309.

We do not ask for more money from local mines/corporations unless there are exceptional cases that the farmers have encountered extreme difficulties. For example, one farmer was unable to pay for the hospital fee, the former town mayor telephoned one mine owner to give RMB 5,000 to that farmer because the mayor knew the owner quite well. In general, the town Party secretary and mayor have close relations with mine owners or entrepreneurs by having meals together sometimes. Since mines/corporations are managed by town government, they still need the approval of town Party secretary and mayor, and relevant cadres. You can't manage all things relying on formal institutions, some private relations may make things easier.<sup>179</sup>

Mr. Qiu's explanation matches that of Mr. Shao (see Chapter 5) in recognizing that personal relations, together with other informal institutions, interlock with formal pairing schemes and mobilizing meeting in the process of fund raising at or across county and town levels.

### **6.2.3 Redistribution Mechanisms**

A large number of mines and coal-related corporations in Xinmin Town pair with villages located in their business operation areas that create a pairing model representing the business operation area. In 2007, 14 villages were paired with mines or coal-related corporations that accounted for 82.4% of total administrative villages. The town government has introduced a package of measures to compensate for structural poverty and address conflicts of interests under the pairing schemes. From 2006 to 2010, farmers' average income increased by 2.66 times and their production and living conditions were greatly improved through buying shares in enterprises/mines, renting land to enterprises/mines, working in enterprises, contracting construction projects and providing service trade.

#### ***6.2.3.1 Purchasing Shares and Earning Dividends***

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<sup>179</sup> INT-18-201309.

During the coal resource integration process, Fugu County Government proposed that farmers buy individual shares in mines to share the benefits. In 2010, Xinmin Town Government thus institutionalized it and regulated that all mines in Xinmin Town sell in the range of 1% -5% of the shares to the farmers who lived in mine operation areas.<sup>180</sup> The regulation integrates the farmers with mines in the sense that farmers become the “minor shareholders” (stakeholder) to participate in the mine business and support its development.<sup>181</sup> On the one hand, the idle capital in the hands of farmers was introduced as new investment capital into the coal mines to a certain degree. On the other hand, the shares bind the farmers and coal mines tightly together in terms of profits. The mechanism has made farmers immediate stakeholders to participate in the business practice, in other words, helping maintain a peaceful and smooth operation environment. Mr. Wu made the following claims:

It seems that we earn less once the farmers purchase individual shares, in actuality, we do not suffer losses (*chikui*) in the long run. They help to maintain the business operation environment. When the mine has to stop producing and does maintenance work, the farmers are concerned with the halt. Due to the enormous support among the farmers who have purchased shares in the coal mine, my mine has run lucrative business for six years. In addition, we have completed the technical reformation six months ahead of time, although the state allows a 20-month reformation.<sup>182</sup>

The joint Party branch and village committee organize the local farmers to buy shares in the form of cash and land transfer. By 2011, about 31% of the farmers in seven mine towns in Fugu County had bought shares, which accounted for 3% of total shares. In particular, the farmers’ shares in Xinmin Town had reached 5%, in which cash purchases

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<sup>180</sup> None of the coal mining companies in Fugu County was publicly traded. Neither were the shares purchased by farmers publicly circulated. The threats to the ability of the coal mines to pay dividends would reduce the value of personal shares.

<sup>181</sup> The farmers who purchase individual shares have no voting power.

<sup>182</sup> INT-11-201310.

accounted for 3.5% and land transfers for 1.5%.

Before the regulation was launched by Xinmin Town Government, an important case took place in one administrative village that was a dense coal mine area with a high frequency of conflicts of interests between the village and the mine. The mine owner decided to incorporate all the farmers by having them buy shares in his mine. All the farmers bought the shares and got the dividends in the same year. Afterwards, he was elected as the village Party secretary by other Party members.

These symbiotic relations between villages and enterprises/mines, coupled with the intervention offered by the town government, have turned the farmers into “minor shareholders” (stakeholder) and tied their benefits closely with the mines to transfer benefits to the farmers. Mr. Qiu took the following view:

The farmers get considerable benefits from the dividends, and become more and more supportive to the mine business, unlike before, they always impeded the business operations when there were conflicts of interests. It is a good way to achieve a win-win outcome.<sup>183</sup>

#### ***6.2.3.2 Promoting Indigenous Employment Programs***

Fugu County Government has implemented the indigenous employment programs by explicitly regulating that private enterprises should accommodate at least 60% of employees from Fugu County, and central and provincial projects should accommodate at least 30% of local employees. It serves two purposes: one is to improve the local people's livelihoods by providing employment opportunities; the other is to secure enough labor for local enterprises, in case they encounter a labor shortage. By 2011, approximately 116,000 people were employed in industrial and mining enterprises in Fugu County. In the meantime, Xinmin Town Government has stipulated that, under equivalent conditions, all mines should give preference in recruitment to indigenous farmers. The village-

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<sup>183</sup> INT-17-201211

enterprise joint Party branch thus not only organizes farmers to buy shares in mines, but also helps those farmers who do not have money to buy shares to find jobs in the enterprises located in their village areas.

The job selection is interesting, for almost all the miners are from outside Fugu County, a large portion being migrant workers from Sichuan and Shanxi Provinces. One reason is that the local farmers are not willing to do the dirty and dangerous mining work in the pit<sup>184</sup>; another is that the mine owners are reluctant to hire local farmers for mining because they request far larger compensations than the outsiders in the case of accidents. To avoid unnecessary troubles, the mine owners prefer to employ workers hailing from neighboring provinces. As Mr. Zhang put it, “[w]e give the profits made by migrant workers from Shanxi Province back to Fugu’s populace.”<sup>185</sup> The relatively few decent jobs do not even attract local farmers in Xinmin Town because compared to working hard and earning less, they pursue fast and easy money from land lending and shares in mines.<sup>186</sup>

### ***6.2.3.3 Contract Construction Projects***

The local state requires, under equivalent conditions, that construction materials be provided by the local farmers. Industrial companies and mines should let local farmers and construction companies contract to build the infrastructure.

### ***6.2.3.4 Develop Service Trade***

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<sup>184</sup> INT-08-201211.

<sup>185</sup> INT-01-201210.

<sup>186</sup> INT-17-201211.

The last measure is to encourage the farmers to develop service trade in the mine areas, including transportation, catering, accommodation and recreation services. Moreover, the local government demands that enterprises and mines give priority to the local truckers for the transportation business. Many farmers, accordingly, buy dumper trucks to transport the coal for the mines. However, the farmers consider driving long distances a hard job, so they hire drivers from outside of Fugu County to do this.

#### **6.2.4 Conflict Mediation Mechanisms**

##### ***6.2.4.1 Village-Enterprise Joint Party Branch***

There are currently 17 Party branches administered by Xinmin Party committee, including 11 village Party branches, three village-enterprise joint Party branches and three government Party branches.<sup>187</sup> In 2009, Xinmin Town Government set up a village-enterprise joint party branch mechanism to mediate the conflicts of interests between farmers and mines/enterprises. In the system, 17 village party secretaries have been assigned to mines as deputy managers. The village party secretaries are assigned to the joint party branch as party secretary, and the enterprise managers are deputy party secretaries of the joint party branch. When a conflict arises, the intertwined party secretary and enterprise manager try their best to settle the dispute. On the one hand, the joint party branch is mainly responsible for assisting the development of villages and obtaining benefits for farmers, for example, the joint party branch arranges for the farmers to buy shares in mines, find jobs in enterprises, etc. On the other hand, it mediates the conflicts of interests between farmers and enterprises in order to remain there and address the conflicts within villages. When the conflicts cannot be addressed within villages, the town government is involved. In a worst case, the farmers then go to

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<sup>187</sup> In 2011, the administrative villages of Xinmin Town decreased from 17 to 11 in a town planning drive, dismantling townships and merging administrative villages.

county or upper authorities to complain when they are not satisfied with the results mediated by the town cadres. Consequently, the county and town cadres are faced with political legitimacy from local level and a performance evaluation from the upper authorities. Thus remaining and addressing the conflicts within villages is the key task for the Party secretary of the Joint Party branch. The Party secretary's skills, knowledge and prestige facilitate the dispute settlement in the negotiation process. As Mr. Qiu put it:

We have several high level village party secretaries and village directors in Xinmin Town. They know both the details of villages and corporations quite well. When the conflicts arise between villages and mines/corporations, the village Party secretary just goes and talks to the village and the corporation and then settles the dispute.<sup>188</sup>

In fact, the joint party branch mechanisms use *mianzi* of the village party secretary and corporation manager who are bonded together to address the conflicts. Because of *mianzi*, the two party secretaries try to reach an agreement as soon as possible. The joint party branch interlocks the corporations with the village in the course of sharing benefits. Mr. Sun, the party secretary of one administrative village and the joint party branch of Company A, has some shares in a coal-related production company. He has been elected as village Party secretary since 1991, and admitted that he is accepted by most local residents.<sup>189</sup> In other words, he has high prestige among the farmers in all village affairs. He described the process of addressing a conflict as doing a business. Furthermore, he explained how the joint Party branch works as a mediation mechanism:

The joint Party branch functions as a mediator. The most intense conflicts happened between 2006 and 2009 in our village, and the main dissatisfaction involved land acquisition. What I do is to coordinate the interests of two parties, advising farmers to ask for less money and enterprises to pay more so that they can reach a consensus. I meet the deputy Party secretary, who is also the vice general manager of Company A, once every week, discussing the needs of the local people and the enterprises. We work together to find out the best solution to both parties. For example, if

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<sup>188</sup> INT-17-201211.

<sup>189</sup> INT-03-201210

the company wants to use the land of individual farmers, we get the farmer and company together to negotiate the price.<sup>190</sup>

Apparently, Party secretary's skills, knowledge and prestige, and *mianzi*, as informal factors facilitate the dispute settlement in the negotiation process. The relations between farmers and enterprises are improved because the joint Party branch plays a salient role in mediating the conflicts of interests between villages and enterprises. Table 6.1 presents the comparisons of conflicts mediated in Xinmin Town from 2008 to 2011. The figures from 2009 when the joint Party branch institution was established drop sharply. In addition, the mines and enterprises invested over RMB 0.3 billion in improving the infrastructure and living environment from 2009 to 2011.

**Table 6.1: Change of Conflicting Cases and Compensation Funds before and after the Establishment of a Joint Party Branch in Xinmin Town**

Year	Conflicting Cases	Change (%)*	Compensation Funds (billion RMB)
2008	182	+8%	0.0860
2009	146	-21%	0.0650
2010	119	-19%	0.0575
2011 (till June)	39	-22%	0.0226

\* Compared with the same period last year.

Source: Own compilation

The village-enterprise joint Party branch in Xinmin Town is highlighted as an institutional innovation and best practice by Fugu County Government. The model is further disseminated in those regions with rich natural mineral resources by the central state. Up until June 2011, Fugu County Government had set up 175 Party organizations in the non-public sectors, in which, 55 village-enterprises were joint Party branches. 31 core

<sup>190</sup> INT-03-201210.



Party leaders in enterprises hold a post in the joint Party branches. Furthermore, 46 village Party secretaries and directors were sent to 46 mines as deputy managers. The Party-based mediation mechanism functions as a platform to not only connect the village and enterprise to build a harmonious negotiation environment, but also as a vehicle to distribute the benefits.

#### **6.2.4.2 People's Mediation Committee**

In fact, before the joint Party branch mechanism functioned well, the People's Mediation Committee (*mintiao weiyuanhui*) was already set up by Xinmin Town Government in 1998. Unlike the joint Party branch, it is composed of only local cadres, excluding the managers of enterprises. It is led by the core leaders of Party committee, government and people's congress, filled by relevant governmental cadres from the disciplinary inspection, the organization, the justice and the civil affairs departments and the police station. The People's Mediation Committee serves the villages that haven't established joint Party branches or those that may be unable to address conflicts through the joint Party branch. It functions in a similar way to the joint Party branch in that the core principle of the mediation mechanism is to help the farmers get benefits from enterprises/mines. Mr. Qiu made the following claims:

The farmers rely much on the government. Compare to enterprises, the farmers are disadvantaged groups. We should help them to get some real benefits (*shihui*) from the enterprises/mines.

Furthermore, if the business is interrupted, the owner will lose a lot of money. Actually the money the owner returns to the farmers is not worth mentioning, compare to the money he loses.<sup>191</sup>

Before 2011, all 17 village committees set up People's Mediation Committees. In this sense, there are three types of People's Mediation Committee at different levels, including a village committee, a joint Party branch and town level. Initially Xinmin Town Government tended to let the civil dissension among farmers be mediated at village level,

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<sup>191</sup> INT-17-201211.

however, when more and more conflicts involved village and mine/enterprise, the joint Party branch was set up. If any case arises at the town level, the town mediate committee then intervenes.<sup>192</sup> The three-layer mediation mechanism associated with economic measures stopped people appealing to the upper authorities for help from 2009 to 2011.

### **6.3 The Case of Wujiazhuang Town**

#### **6.3.1 The Research Site**

Wujiazhuang Town is a purely agricultural town. It lies in southern Fugu and is 40 kilometers from the county, covering 240.75 square kilometers, of which the size of arable land is 75,861 *mu*.<sup>193</sup> The town has a population of 15,696 inhabitants in 4,608 households. It manages 22 administrative villages, 90 natural villages and 18 governmental institutions.<sup>194</sup>

##### ***6.3.1.1 The Rise of a Demonstration Village***

As Schubert and Ahlers (2012) note, local governments in Shaanxi Province prefer to establish model villages (or piloting villages, demonstration villages, key villages) to lead rural development in the implementation of the CNSC program. The local state has

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<sup>192</sup> INT-17-201211.

<sup>193</sup> Equivalent to 50 square kilometers or 5,057.4 hectares (1 hectare = 15 *mu*)

<sup>194</sup> In 2011, according to the town planning policy of dismantling townships and merging administrative villages, the administrative villages of Wujiazhuang Town increased from 11 to 22, natural villages from 51 to 90 by merging Wangjiadun Township, also a purely agricultural township. See *Danwei jianjie* (An Overview of Wujiazhuang Town). Website of Fugu County Government. [http://www.fg.gov.cn/Category\\_345/Index.aspx](http://www.fg.gov.cn/Category_345/Index.aspx) (accessed 5 October 2015).

adopted diverging strategies in respond to local conditions. According to the “Comprehensive Plan for the CNSC Program (2007-2012),” in 2006, Fugu County Government identified 13 demonstration villages at prefectural city level. Gaozhuangze Administrative Village became one of the 13 demonstration villages. It is located in Wujiazhuang Town, 13 kilometers away from the town government and is composed of three natural villages and has 363 residents in 96 households. The arable land is 1,800 *mu*.<sup>195</sup> An internal report by Fugu’s Party Department of Rural Work highlights that the majority of farmers from this village work in Group B. Some of them hold managerial or technical positions. Some of them have purchased shares of Group B. Why has Group B employed such a large amount of farmers from this village as workers? One explanation claims that the founder who holds the majority of shares of Group B was born and grew up in Gaozhuangze Village and he was concerned with the livelihood of the farmers in his home village.<sup>196</sup> Mr. Zhu elaborated that young people who are educated all go to work in the headquarters (Group B) situated in the county center. Others who are not educated stay working in the agricultural development company of Group B located in Gaozhuangze Village. The people working in the headquarters are entitled to purchase individual shares, while currently workers in the agricultural company are not. In general, Group B and its agricultural company have provided jobs for the farmers.<sup>197</sup>

In fact, before the “Double Hundred” project, the owner of Group B spontaneously spent RMB 51.22 million in poverty alleviation projects, including infrastructure construction, relocation project and helping those people in need (see Appendix II). Many of the projects were carried out in his hometown. In 2006, knowing his hometown was identified as the demonstration village, the owner spent RMB 12 million on improving the living conditions by building modern homes with adequate facilities (i.e. tap water,

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<sup>195</sup> Equivalent to 120 hectares

<sup>196</sup> During my field research, Group B was not trading on the stock exchange. The shares purchased by the workers were not publicly traded. Group B paid dividends to these shareholders at the end of every year.

<sup>197</sup> INT-06-201211.

toilets) to move his village fellows out of cave houses dug into the loess. As argued in Chapter 4, the spontaneous engagement in poverty alleviation and rural development of a few leading entrepreneurs inspired the local officials to initiate the “Double Hundred” project, uniting 33% of mines and coal-related corporations in implementing the rural development project and solving the financial constraint in terms of development funds. Observing that the owner of Group B has a close affinity with his home village, the local state paired Group B with Gaozhuangze Village.

In 2007, the local officials persuaded Group B to participate in agricultural development in accordance with the Comprehensive Plan for Fugu’s CNSC Program (2007-2012) by inviting experts from the Planning and Design Institute of the Ministry of Agriculture to draw up a “Plan for Gaozhuangze Modern Agriculture Base.” Finally, Group B decided to invest RMB 0.15 billion in the agricultural development project that covered and benefited three administrative villages, eight natural villages with 1,058 residents in 290 households. In contrast with the overwhelming amount of development funds collected by Group B, the local government appropriated RMB 5.73 million as earmarked and matching funds, in which, the matching funds provided by agriculture-related departments was only RMB 1.88 million. Nevertheless, before the model of the demonstration village was identified, government departments refused to contribute funds to the CNSC program in order to protect their own interests within their departments. The projects of demonstration villages have united the members of strategic group that build alliances in pursuing and maintaining their common interests with regard to effective implementation of the rural development program. The agriculture base consists of a few distinct function areas, for example, residential areas, breeding and processing areas, greenhouse vegetable planting areas and ecological tourism areas. Wujiazhuang Village thus has not only enjoyed government funds, but also political interest from the upper authorities because it is the main destination for the regular inspection teams sent down by the county, city and provincial governments. Based on the demonstration effect of Gaozhuangze Village, the local cadres undertook strategies to propose that the agriculture base at the prefectural city level upgrade to the provincial-level modern agriculture demonstration zone. In 2012, the proposal was approved by the provincial authorities.

The total budget has increased to RMB 5 billion and the investment made by Group B has reached RMB 0.5 billion. The upgraded demonstration zone involves Fugu and Shenmu Counties, covering five towns and 26 administrative villages and has expanded from eight to 303 square kilometers.

### **6.3.2 Fund Raising Mechanisms**

Unlike Xinmin Town, the purely agricultural towns find it difficult to collect funds from the mines/corporations because county governments basically pair them with villages based on their wishes. Since there are no conflicts of interest involved, many mines/corporations are reluctant to pair with the purely agricultural villages unless the mine owners/entrepreneurs have personal ties with the villages, for example, as ancestral hometowns and birthplaces. Wujiazhuang Village seems lucky to have had such an entrepreneur born in that village 53 years ago and who grew up there, and who now owns a company (Group B) with a registered capital of RMB 2.158 billion. Mr. Cao explained why the owner of Group B decides to aid his home village instead of other villages in the “Double Hundred” project:

We help the government to solve problems, for example, the infrastructure construction. The government says that the owner has a lot of money so it persuades the owner to spend money on large-scaled infrastructure construction. The owner is not stupid, and he chooses his hometown to continue rural development projects under the rubric of the “Double Hundred” project.<sup>198</sup>

Following the mobilizing meeting organized by the Leading Small Group at county level, town governments, as the major fund raisers of the “Double Hundred” project, have to organize various meetings (i.e. pairing meeting, group meeting) in order to receive the funds promised by mines/corporations in a timely manner. According to the pairing schemes, Group B and seven mines outside of Wujiazhuang Town arranged to aid Wujiazhuang Town. As the town mayor claimed, in contrast to Group B, it is rather

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<sup>198</sup> INT-05-201211.

difficult to get funds from the mines on the pairing list.<sup>199</sup> She further elaborated how the informal institutions are present in the interactions between town cadres and mine owners/entrepreneurs in the process of pairing meeting organized by the town government in order to push the mine owners/entrepreneurs to send funds:

The pairing meeting is usually directed by the Party secretary. But he was transferred to another town at that time, so I took over the job to organize the pairing meeting. First, I contact the corporations in advance and visit the owners in person. I bring along with the documents issued by the county government, explaining the details of documents. After visiting all owners, I invite the owners to the pairing meeting, emphasizing that they have to attend the meeting not mention the funds they want to give. By doing that, I have to coordinate their available time. Then I contact some corporations by inviting the owners to meals, hoping them to take the lead to send intentional funds (*yixiang zijin*) in front of other owners/entrepreneurs. When everything is done, we send invitation letter to the corporations in person.<sup>200</sup>

After the pairing meeting, town leading cadres have to follow up the mines/corporations closely until their funds flow into the town government's earmarked account. By doing this, informal factors (i.e. *mianzi*, local customs in terms of gifts) are involved in the interactions between town cadres and owners/entrepreneurs again. As Mrs. Zhou put it:

The deputy Party secretary and I have to visit the corporations again after the pairing meeting. Both Party secretary and mayor have to present together, because a) It's better to make things done; b) It shows the importance attached to the issue, otherwise the owners will not be happy, saying 'The leading cadres don't come, why should I give you money?' We always bring along with special agricultural products as gifts when visiting the owners. We also invite the owners to meals after we use their funds to implement specific projects, showing our gratitude and the outcomes of the projects they fund. Some entrepreneurs think the county government has already formulated the pairing schemes, plus the town Party secretary and mayor follow up very closely, they finally give us *mianzi* by sending funds.<sup>201</sup>

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<sup>199</sup> INT-22-201211.

<sup>200</sup> INT-22-201211.

<sup>201</sup> INT-22-201211.

In addition, Wujiazhuang Town Government uses the personal networks in which the owner and his family are embedded to raise funds in order to implement the “Double Hundred” project. For instance, in 2011, the town Party committee manipulated Gaozhuangze Village’s Party secretary election by appointing the nephew of the owner as the official candidate. Then the village Party members cast the inner-Party vote and the nephew of the owner’s clearly won the Party election and acted as Gaozhuangze Village’s Party secretary.<sup>202</sup> Obviously the town Party committee violated the two-ballot system adopted in Fugu County in 2005<sup>203</sup> and the village party election was thus a formality.<sup>204</sup> In addition, the administrative affairs of the village fell to the deputy Party secretary, while the Party secretary only attended the meetings convened by upper authorities. However, the town officials reinforced the ties with the owner indirectly through his nephew and the kinship networks they are embedded in. In this sense, the town cadres have effectively incorporated the owner and his family members in the implementation of the rural development project. As Mr. Zhu explained:

The town government appointed the nephew of the owner's to be Gaozhuangze Village's Party secretary because he is the relative of the owner's and he also manages one of the coal mines of the owner's. He and the owner are both very generous to the government and populace. For instance, even though he doesn't live in the village anymore (albeit his household registration,

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<sup>202</sup> See internal report: “*Womende zuji:fugu xian shehui zhuyi xinnongcun jianshe jishi*”(Our Footprints: Record of Fugu’s CNSC Program Implementation, P15.)

<sup>203</sup> The two-ballot system was initially enacted by Hequ County’s Organization Department in response to villagers' complaints in 1992. According to the system, villagers recommend candidates for the positions of party secretary, deputy party secretary and party branch committee members by casting a vote of confidence (*tou xinrenpiao*). Only those who receive 50 per cent of the popular vote become preliminary candidates in the first round. The township party committee nominates its preference as official candidates and then the village's party members elect the village party secretary and the various members of the party branch committee in the second stage. See detailed analysis of the two-ballot system and its impact on the national policy of grass-roots government election and governance, see Li (1999) and Jing (2003). The two-ballot system was adopted in Fugu County in 2005, see *Fugu kaizhan baicun diaoyan qianghua jiceng zuzhi jianshe* (Fugu Conducts Surveys in 100 Villages and Strengthen the Building of the Grassroots Organizations). Website of Shaanxi Economy. <http://www.sei.gov.cn/ShowArticle2008.asp?ArticleID=55368> (accessed 5 October 2015).

<sup>204</sup> INT-06-201211.

*hukou*, remains in Gaozhuangze Village), he returns to give money to the elderly people of no family of the village.<sup>205</sup>

### 6.3.3 Redistribution Mechanisms

As noted in Chapter 5, local cadres have adopted two approaches to carrying out the specific rural development projects. For the giant projects where investment exceeds RMB 10 million, the funds are kept and the projects are implemented by the corporations. For instance, Group B set up a Head Office of the CNSC program in Gaozhuangze Village to coordinate various rural development projects. Under the head office, an agricultural development company was established in 2008 and the former cadres sent by the local government became the managers (See Chapter 4).

The agricultural development project implemented by Group B adopted distinct approaches to compensating farmers with regard to relocation and benefit distribution in accordance with different standards within three administrative villages. First, in 2006, the owner of Group B started to build 66 luxurious town houses, each with a floor area of 330 square meters, for the farmers living in Gaozhuangze Natural Village that is his birthplace. He was inspired by Huaxi Village<sup>206</sup> and imitated it by building a well-off village to relocate all the farm households in his home village from their cave houses.<sup>207</sup> Second, he built Chinese style bungalows for those farmers living in another two natural villages under the Gaozhuangze Administrative Village.<sup>208</sup> Third, as the project involves three administrative villages that provide essential lands, he has carried out a benefit

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<sup>205</sup> INT-06-201211.

<sup>206</sup> Huaxi Village is claimed to be the richest village in China. For more details, see *Huaxi gaikuang* (An Overview of Huaxi Village). Website of China Huaxi Village. <http://www.chinahuaxicun.com/main.htm> (accessed 5 October 2015).

<sup>207</sup> INT-07-201211.

<sup>208</sup> INT-07-201211.



distribution system: (a) All the households get daily supplies, such as rice, flour and oil during the Chinese New Year; (b) farmers over 60 years old within Gaozhuangze Administrative Village receive RMB 2,000 as a pension per year, while those from the other two administrative villages receive RMB 1,500 per year.<sup>209</sup> The explanation is that the owner has special affection for his birth place that is deeper than for those outside of that village. As Mr. Cao explained:

He [the owner of Group B] himself is a farmer, was born and grew up in a poor famer's family. Now he is rich, and he hopes to help his fellows from his birth place to move in the town houses and build a well-off hometown.<sup>210</sup>

Mr. Cao's explanation matches Mrs. Zhou's claim.<sup>211</sup> The lower compensation standards of the other two administrative villages mean the agricultural development company is in need of lands as it expands its business. In this sense, the company has to make compensation to the farmers in accordance with the lower standards they experience compared to those in the owner's birth place.

To generate income for local farmers, the company has distributed greenhouses equally among households based on the number of households. The farmers contract the greenhouses free of charge and all utilities used for growing vegetables are paid by the agricultural development company. In this sense, the farmers plant and manage the greenhouses by themselves, and increase their income. In addition, the farmers of the three villages have priority to work for the company. For instance, Mr. Xie, who is a farmer in Gaozhuangze Administrative Village, has worked for the agricultural development company as a forester since 2012. He claimed the priority given to the local

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<sup>209</sup> INT-05-201211.

<sup>210</sup> INT-05-201211.

<sup>211</sup> INT-22-201211.

farmers as a principle of the company.<sup>212</sup> Because he doesn't have enough labor to grow vegetables, he has leased his three greenhouses to a farmer in his village. The contractor could earn approximately RMB 30,000 per year.

#### **6.3.4 Conflict Mediation Mechanisms**

Since the agricultural development project involves many villages, the situation is more complex than in Xinmin Town, that is characterized as a coal-related business operation area. Despite the owner of Group B building modern houses compensating for the farmers in his home village and distributing pensions for old farmers in the project villages proactively, it does not mean that there are no conflicts at all. In fact, the conflicts arising as a result of the expansion of the agricultural development project are mainly in close relation to the land but are more complex because the various compensation mechanisms are based on different standards.

The agricultural development company started to rent land from Gaozhuangze Administrative Village in 2007 and the other two administrative villages from 2009. The initial contracting price is RMB 150 per mu per year, for each additional five years, the price increases RMB 20 per mu per year. The contracting period is 50 years for Gaozhuangze Administrative Village, while 30 years for the other two administrative villages. How are the interests of farmers and the agricultural development projects coordinated? The local cadres play a role as mediator to address conflicts by adopting a land circulation approach. The natural village regains the ownership of land to lease to the agricultural development company.<sup>213</sup> Mr. Zhu, the deputy party secretary of Gaozhuangze Administrative Village explained how the town government and village cadres got involved in signing the contract of land circulation with the company:

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<sup>212</sup> INT-07-201211.

<sup>213</sup> For more details on the issue of land ownership in China, see Ho (2001).

Since many farmers have already left the villages and thus substantial land is uncultivated. To facilitate the agricultural development company to rent the land, the natural villages regain the ownership of land that was distributed to farmers before. Therefore, the land is collectively owned, leased to and used by the development company. We, administrative village cadres, have to identify the circulated land in accordance with town government's development plan, and then the natural village cadres convene farmers meeting that both men and women of households have to attend. In Fugu, men used to make decisions in families, but on the issue of agricultural development company, men and women are required their signatures and thumbprint on the contract once they agree.<sup>214</sup>

#### ***6.3.4.1 People's Mediation Committee***

Compared to Xinmin Town, conflicts arise between the agricultural development company and the villages much less frequently and are milder in Wujiazhuang Town. According to my field observations and interviewees' talks, the conflicts of land use arise mostly between the company and farmers from outside Gaozhuangze Administrative Village. As Mr. Tang claimed:

There is no resistance when the company uses the land of Gaozhuangze Administrative Village. Farmers basically have no objections to the contracting price because the owner of Group B has a great affection for his hometown and farmers. Thus he has really done a lot of projects for his home village. In return, the farmers of his home village provide great support to all his projects. However, when the company contracts other villages' land, the conflicts arise and the governments are needed to coordinate them.<sup>215</sup>

His claim echoes Mr. Xie, the farmer of Gaozhuangze Administrative Village, as well as the employee of the agricultural development company,<sup>216</sup> and Mrs. Zhou, the head of

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<sup>214</sup> INT-06-201211.

<sup>215</sup> INT-23-201211.

<sup>216</sup> INT-07-201211.

Wujiazhuang Town.<sup>217</sup> As argued earlier, the village-enterprise joint party branch in Xinmin Town is highlighted as an institutional innovation and disseminated as example of best practice by Fugu County Government. None-the-less, the joint party branch established by the agricultural development company and Gaozhuangze Administrative Village merely functions in a formalistic way because conflicts hardly arise between the two entities. Instead, the conflicts that arise between the company and other villages are coordinated by the People's Mediation Committee. Unlike the mediating body in Xinmin Town that is led by the core leaders of Party committee, government and the people's congress, filled by relevant governmental cadres from the disciplinary inspection, the organization, the justice and civil affairs departments and the police station, the mediating team in Wujiazhuang Town is only composed of leaders and cadres in charge of the villages and town deputy cadres (i.e. deputy Party secretary or secretary of disciplinary inspection). Mrs. Zhou explained the reason why the town government does not follow Xinmin Town in forming a sophisticated mediating team and how the mediation mechanism works;

We do not spare cadres for the conflicts deliberately because we don't have as big a work load as Xinmin Town does. The mediating team mostly serves to coordinate lands for the agricultural development company. When the conflicts arise, the mediating team visits the farmers and check if the complaint is true. If it's true, the mediating team communicates with the company and finally summons the two parties to coordinate their interests. We usually do ideological work (*sixiang gongzuo*) on both sides. On the one hand, we stress the points to farmers that Group B is developing agriculture in the villages instead of mining. The roads built by the company benefit everyone. Without the owner of Group B, it is unlikely that the villages get access to the outside world. If you demand to dig wells or build roads for villages, it's possible to fulfill your wishes. But if you only want more money to split, it's definitely rejected by our government. On the other hand, we convince the company to compensate for the famers' land. We have only one company and the owner is from this village, it's much easier to convince the company than the farmers. In the end, the company and the farmers reach an agreement.<sup>218</sup>

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<sup>217</sup> INT-22-201211.

<sup>218</sup> INT-22-201211.

## 6.4 Summary

By reviewing the diverging patterns of strategic agency implemented by Xinmin and Wujiazhuang Town governments in the “Double Hundred” project, I draw up some commonalities and differences between the two case studies.

Both town governments have adopted mechanisms in order to raise funds, compensate farmers and address conflicts of interests that arise between mines/corporations and villages. Several informal factors (i.e. local customs, personal relations, prestige, skills, knowledge, affinity and *mianzi*) underline the formal institutional arrangements outlined above. Personal relations, prestige and *mianzi* are found quite often and are useful in the process of fund raising and dispute settlement. However, Wujiazhuang Town has used much more informal institutions to raise funds since the town cadres face fiscal constraints. In this sense, the government relies on financial appropriation from the upper authority and pairing enterprises to generate funds.

The differences lie between the two counties in the following aspects. First, the mines and corporations in Xinmin Town are voluntarily compelled to pair with local villages in the business operation areas because they have to respond to the social and economic pressures exerted by the farmers. If they do not make the farmers happy, the latter constitutes an interruption in business practice, in other words, the farmers’ dissatisfaction leads to economic loss. For the government, intensified dissatisfaction causes the local cadres to experience social and political pressures that may cause instabilities that challenge political legitimacy and make trouble for the cadres through the loss of their jobs. The local state coordinates the interests of the locality by mobilizing corporations to fulfill CSR initiatives through pairing schemes voluntarily. The corporations and mines are paired with villages and “donate” funds in accordance with the task formalized by the state. While in Wujiazhuang Town, before the implementation of the CNSC program, Group B carried out rural development projects in the owner’s

home village voluntarily because he had a close affinity with his hometown. He thus decided to continue to aid his hometown by officially pairing with Gaozhuangze Administrative Village through the town government. However, the compensation standards varied in his birth place and the other two project administrative villages. The owner offered free townhouses to the farmers in his birth place because of his special affection for the area that was deeper than for those outside that village. The lower compensation standards of the other two administrative villages meant that the agricultural development company was in need of lands to expand its business. In this sense, the company has to compensate the farmers due to their lower standards compared to those in the owner's birth place. Second, Xinmin Town has much more severe conflicts between villages and mines/corporations. Thus the mediation mechanisms in terms of the village-corporation joint Party branch, the People's Mediation Committee and village committee play important roles in coordinating the conflicts of interests, in particular, the joint Party branch interlocks the corporation with the village by uniting their common interests in terms of business practice and profits. In Wujiazhuang Town, the owner's local identity and his proactive and voluntary investments in improving the locality's living and production conditions are part of the reason why the conflicts have decreased. In this sense, the joint Party branch merely functions in a formalistic way. Instead, the People's Mediation Committee mainly involves the town cadres in the negotiation process.

## Chapter 7. Conclusion

### 7.1 Preamble

The concluding chapter summarizes the core research findings and evaluates the research contributions. It closes with research reflections and suggestions for further research agendas.

### 7.2 Summary of Findings

Applying the sociological perspective, this dissertation has explained the political economy of institutional change in property rights, extractive, redistributive and mediative institutions and how these formal institutions interacted with various informal institutions in the process of rural social policy implementation in rural China. The institutional change process is highly path dependent. Dependence on local coal endowments on the one hand, and the form of property rights, economic, extractive, redistributive and mediative institutions on the other hand combined to create apparent path dependence in the implementation of CNSC.

The study has been structured by the following three central research questions: **(1) why do variations exist in project implementation under the unified framework of national policy programs and political ideology? (2) How do local governments respond to the institutional constraints? (3) How is the centrally-initiated rural development project implemented by local governments?** The main findings with regard to the first question have been shown in Chapter 3 and identify how the revenue-sharing fiscal systems and cadre evaluation system as the main institutional constraints, together with the tax-and-fee reform, influenced local officials' behavior and policy outcomes. In the 1980s and early 1990s, the incentive structure contained in the cadre evaluation and fiscal systems impelled local cadres to expand the tax base in order to

increase revenues and concurrently finance the provision of public goods and social welfare programs devolved by the central state. Since the 1994 tax division system took effect, the requirement to match funds extracted from the budgetary revenue to fund rural development program (i.e. CNSC) has reinforced the institutional prerequisites for the rise of a private enterprise economy and county-wide economy.

As a result, the local governments have developed various strategies to engage in economic activities in order to promote socioeconomic development. As Chapter 4 has shown, the rise of “Local State Entrepreneurial-Developmentalism” is reflected in the first research proposition: **local officials regained state ownership of private firms because they must lower the transaction and information costs and reduce the bargaining power of private capital.** Local officials in Fugu County, on the one hand, used managerial strategies to turn the private dominated economic structure into a state dominated mixed ownership. On the other hand, the local state offered inducements to the private sector by providing credit and financial consulting, market and technical assistance, tax breaks and support funds and conflict mediation. Only under these favorable conditions, was the private sector able to weather the economic crisis and generate substantial tax revenues.

Nevertheless, extracting matching funds from the budgetary revenue was insufficient to fund CNSC because the local state must finance the provision of mandated public goods and the social welfare program as well. Indeed, the officials were faced with limited disposable incomes. Thus, raising matching funds from outside the budgetary revenue is the second important strategy to fund CNSC. The findings with regard to matching fund raising and CNSC implementation in Fugu County have been shown in Chapters 5 and 6. Leading county and town cadres formed a “Strategic Group,” which is characterized by an open and informal network and consisting of people at various levels who share common interests, to devise the “Double Hundred” project in line with CNSC and co-opt the private entrepreneurs into the strategic group. Formal and informal institutional dynamics are reflected in the second research proposition: **the formal and informal institutions closely interacted in the process of implementing the “Double Hundred”**



**project, for example, in the formation of strategic groups and in the process of extracting matching funds, redistribution and conflict mediation through pairing schemes.** Compared to the formal institutions including regular work meetings and Party school trainings, the informal institutions consisting of social customs, norms and local knowledge, personal relations (*guanxi*), glory (*rongguang*) and *mianzi* were also very important for leading county and town cadres to identify a collective identity and possess a common life style. CSR was used as the second approach for raising matching funds and implementing the “Double Hundred” project. In China, CSR is perceived by the government as the same as if it had stemmed from the Anglo-Saxon world where companies should integrate social and environmental concerns in the way they operate. However, due to the institutional environment and constraints, CSR practice in China is mandated and led by the state rather than on an enterprise-oriented voluntary basis. As CSR has become the solution to redressing the negative effects of market economy and activities, the local state adopted CSR to justify their behavioral pattern of redistributing resources through direct compensatory fiscal transfer from the private sector to affected farmers and the giving of charity to the county as a whole, and town cadres raising the matching funds from the private firms/mines through pairing schemes that paired private firms with aided villages.

As Chapter 6 has shown, variations in the “Double Hundred” project implementation exist in different towns. Two comparative case studies of institutional arrangements for extracting matching funds, redistributing resources and mediating conflicts have both demonstrated that the informal institutions (i.e. local customs, *guanxi*, prestige, skills, knowledge, affinity and *mianzi*) closely interacted with the formal extractive, redistributive and mediative institutions. Nevertheless, the case of Xinmin Town has shown that coal mines and corporations were voluntarily compelled to pair with local villages in the business operation areas because they were faced with social and economic pressures exerted by the farmers. As a result, town cadres had innovated a package of mediative institutions to coordinate the interests in order to resolve the conflicts between the mines/corporations and farmers. The case of Wujiazhuang Town has shown that one coal mine owner had already voluntarily carried out rural

development practice in his home village prior to initiating CNSC. He had a strong affinity with his birth place, thus a distinctive compensation standard was offered between his birth place and another two project administrative villages. Therefore, the cadres of Wujiazhuang Town used much more informal institutions to raise matching funds than those of Xinmin Town.

### **7.3 Research Contributions**

The dissertation has made several contributions to the existing literature. First, it contributes to knowledge of the institutional change in Chinese political economy and rural development policy implementation, in particular the far-reaching CNSC program. The analytical framework for institutional change in CNSC implementation (see Chapter 1) helps to account for the causal relations between various institutional factors. More importantly, this dissertation strongly claims to be a sociological study because it brings formal and informal institutional interactions into the analysis of rural social policy implementation with the agency perspective of a political economic system.

Second, more broadly, the dissertation contributes to the state-centered literature that China is a developmental state. Building on the notion of the developmental state and Oi's "local state corporatism," this study develops the "Local Entrepreneurial-Developmental State" to highlight the nature of local state involvement in economic growth, marked by both entrepreneurial features of creating and managing new ventures and developmental inducements to the private sector. It further develops an essentially sociological framework of strategic groups to examine the agency of local officials and coal mine owners. These empirical patterns of local entrepreneurial-developmental state and strategic groups contribute to clarifying how agencies structure within China as a developmental state.

The third primary contribution of this dissertation is to provide a new set of original data. The topic of coal mining in China can be sensitive as it relates to workplace safety,

environmental destruction and social unrest. Local officials were sometimes reluctant to release information when collecting data, especially when the above mentioned issues were disclosed by the media, a situation not surprising to those who are familiar with the Chinese political economic system. This study represents my painstaking efforts to achieve deeper insights into China's private coal mining sector and how it functions in the Chinese political economic system and social policy regime, insights which are lacking in the literature, and are attained through in-depth interviews, field observation of natural settings and first-hand documentation collected during field research.

Finally, this dissertation remedies an important gap left by previous scholarship regarding the role of governments in CSR practices and performance. Despite the vast literature addressing the central question of the role of government in relation to CSR in North America and Europe (Albareda et al., 2008), little is known of the role of government in relation to CSR in China. Given that the Western-centric research approach to CSR “may not sufficiently relate or respond to the context and circumstances encountered in developing economies” (Hamann, 2006, p. 179), this study, therefore, highlights an important CSR-related institution created by the local state. It demonstrates empirically how CSR is used and promoted by the local state as an extractive and redistributive institution to mitigate the negative effects of the market economy.

#### **7.4 Critical Reflections and Remaining Questions**

On the one hand, China's economy has entered an early “new normal”<sup>219</sup> status accompanied with a slow rate of economic growth. It also entered a crucial stage of undertaking a structural transformation towards a more liberal market economy: from labor-intensive model to capital/technology-intensive model; from land-led model to

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<sup>219</sup> The economic term “new normal” was first put forward at the fourth plenary session of the 18<sup>th</sup> CCP Central Committee on Oct.23, 2014. It describes an economic status of a crucial rebalancing, in which China diversifies its economy, embraces a more sustainable growth and distributes the benefits more evenly. See *Zhongguo gongchandang dishibajie zhongyang weiyuanhui disici quanti huiyi gongbao* (The Communiqué of the fourth plenary session of the 18<sup>th</sup> CCP Central Committee). Website of Xinhua Net. [http://news.xinhuanet.com/politics/2014-10/23/c\\_1112953884.htm](http://news.xinhuanet.com/politics/2014-10/23/c_1112953884.htm) (accessed 5 October 2015).

consumer-led model; from export-oriented model to domestic and export model.<sup>220</sup> On the other hand, China, as an authoritarian developmental state, is tilting the balance of its endeavors in and commitment to economic growth, environmental protection and social equality. Social policy initiatives and the expansion of the provision of social welfare and public goods will be the focus of developmental strategies as well. Thus, the dramatic economic transformation, the shift of developmental strategies, associated with the top-down anti-corruption and rent-seeking movement, create path dependence and new constraints on and incentives for local governments to cope with the ever-changing institutional environment. Therefore, some questions arise and await further research. The following are just a few of the key issues that face China that grow directly out of the previous economic miracle during the last three decades and the current transformation under Xi Jinping's leadership.

First, the incentives and constraints contained in the fiscal system, the cadre evaluation system, and the national political and macro market environments will reshape local cadres' behavior and responses to the ever-changing environment. As the focus of CCP's developmental strategies has tilted the balance of endeavors in economic development, environmental protection and social equality, the ratios of cadre evaluation system, target responsibility system and national and sub-national County-Wide Economy Evaluation and Praise Work have adjusted accordingly. However, the lion's share of the evaluation system is still dominated by GDP. Under this circumstance, will local governments face greater incentives to promote economic growth? How will local governments transform the economic development structure and model to balance social and environment development? How will the institutional change take place?

Second, changes in ownership in rural industrialization restructure the resource base of local governments. What will happen to government revenues when the private ownership structure changes to a mixed ownership structure? How are the relationships

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<sup>220</sup> See *Zhonggong zhongyang guanyu quanmian shenhua gaige ruogan zhongda wenti de jue ding* (Decision of CCP on Some Major Issues Concerning Comprehensively Deepening the Reform). Website of Xinhua Net. [http://news.xinhuanet.com/politics/2013-11/15/c\\_118164235.htm](http://news.xinhuanet.com/politics/2013-11/15/c_118164235.htm) (accessed 5 October 2015). For the detailed study of China's economic transformation, see Huang (2014).

reshaped between the local government and central government, between the local government and upper level authorities, between the local government and SOEs, private enterprises? Will the mixed ownership structure facilitate socioeconomic development? How do private enterprises respond to the transformation of a mixed ownership structure?

Third, CSR should be offered as a new perspective to examine institutional change during a dramatic transformation for future research. It could go beyond the county level to analyze how CSR as an institutional factor functions to mitigate the negative impacts of the market economy in a broader context, for example, at national, provincial and prefecture levels. How are the relations in the hierarchical control system restructured by CSR? How are the relations reshaped by CSR between the state, business and society?

Fourth, the capacity of rural social policy initiatives generates legitimacy could provide a fruitful agenda for further research. Due to the restriction of space and analytical focus, the heart of this dissertation was on the institutional change in a single rural social policy implementation (i.e. CNSC), which helped to capture the systemic causal effects of institutional factors functioning on each other. Future studies could explore the policy-making circle and examine whether or to what degree formal institutions facilitate the creation of informal institution in the process of policy-making. How do the dynamic interactions work between formal and informal institutions in the policy-making circle? What is the relationship between socioeconomic development and political change?

## **7.5 Summary**

This chapter has reviewed the core findings, theoretical and empirical contributions of the dissertation. In the end, it provides critical reflections and attempts to provide the basis for more informed and precise questions about the current socioeconomic transformation.

## Appendix I. Division of Tax Categories (1994)

Central Taxes	Local Taxes	Central-Local Shared Taxes
Customs duties Value-added tax Consumption tax Enterprise income tax -from central enterprises -from local banks -from foreign banks -from other nonbanking financial enterprises Sales tax, income tax, profits and urban maintenance and construction tax from the railways and head offices of all banks and insurance companies Profit turnover -from central enterprises Tax refunds -to enterprises involving foreign countries	Sales tax -from enterprises other than railways and head offices of all banks and insurance companies Local enterprise income tax -from enterprises other than local banks -from foreign banks -from other nonbanking financial enterprises Profit turnover -from local enterprises Personal income tax Urban land-use tax Fixed-asset investment orientation regulation tax Urban maintenance and construction tax -from enterprises other than railways and head offices of banks and insurance companies House property tax Vehicle and vessel license tax Stamp tax Animal Slaughter tax Agriculture-animal husbandry tax Special agricultural product tax Farmland-use tax Contract tax Inheritance tax Land value-added tax Compensatory payment for appropriation of state-owned land	Value-added tax -75% central -25% local Natural resources tax -offshore oil tax, entral; -all other, local Stock market trading tax -50% each

Source: Adapted from Oi (1999), Appendix B, Table I 3.

## Appendix II. Group B's Engagement in Poverty Alleviation Projects (1998-2007)

Year	Poverty Alleviation Projects	(RMB Million)
1998	Built two village power grids, village road, purchased crop products processing equipment, drinking water supply project	0.14
1999	Built township road, school, power grid, drinking water supply project	0.18
2000	Village drinking water supply project	0.01
2001	Built one school, power grid, aided one school	0.04
2002	Built road, village power grid, drinking water supply project	0.3
2003	Built school, road, drinking water supply project	0.55
2004	Built township and county school roads, school, drinking water supply project	0.32
2005	Built road, drinking water supply project, aided school, hospital	5.892
2006	Built school, road, landline telephone, drinking water supply project, relocation project	28.98
2007	Built road, school, drinking water supply project	1.96
1998-2007	Rural cultural relics renovation and protection	0.8
1998-2007	Aided 4,000 poor people in medical assistance and schooling	8.0
2005-2007	Hardened hometown village road	3.0
Others		1.05
Total		51.22

Source: Lu et.al (2010).

### Appendix III. Table of Informants

No.	Index	Position	Level	Unit
1	INT-01-201210	Office Administrator	Private Enterprise	Company A
2	INT-02-201210	Farmer	Village	Natural Village A1
3	INT-03-201210	Party Secretary	Village	Administrative Village Committee A
4	INT-04-201210	Office Administrator	Private Enterprise	Group B
5	INT-05-201211	General Manger	Private Enterprise	Company B of Group B
6	INT-06-201211	Deputy Party Secretary	Village	Administrative Village Committee B
7	INT-07-201211	Farmer	Village	Administrative Village B
8	INT-08-201211	Senior Officer	County	Rural Work Department
9	INT-09-201309	Senior Officer	County	Rural Work Department
10	INT-10-201211	Senior Officer	County	Local History Department
11	INT-11-201310	General Manager	Private Enterprise	Company C
12	INT-12-201210	Director	County	Bureau of Industrial Economy
13	INT-13-201310	Director	County	Bureau of Industrial Economy
14	INT-14-201211	Party Secretary	Private Enterprise	Company D



15	INT-15-201211	Party Secretary	County	Poverty Alleviation Office
16	INT-16-201309	Party Secretary	County	Poverty Alleviation Office
17	INT-17-201211	Deputy Town Head	Town	Town A
18	INT-18-201309	Deputy Town Head	Town	Town A
19	INT-19-201211	Deputy General Manager	Private Enterprise	Company E
20	INT-20-201211	Employee /Farmer	Private Enterprise	Company E
21	INT-21-201211	Farmer	Village	Natural Village E
22	INT-22-201211	Town Head	Town	Town B
23	INT-23-201211	Office Administrator	Private Enterprise	Company B of Group B
24	INT-24-201209	Chief of Research Section/Researcher	State Council	International Poverty Reduction Center
25	INT-25-201302	Chief of Research Section/Researcher	State Council	International Poverty Reduction Center
26	INT-26-201211	Town Head	Town	Town D
27	INT-27-201211	Accountant	Village	Natural Village Committee D
28	INT-28-201211	Employee	Private Enterprise	Company D
29	INT-29-201210	Office Administrator	Private Enterprise	Company E

30	INT-30-201210	Farmer	Village	Natural Village A2
31	INT-31-201210	Office Administrator	Private Enterprise	Company F
32	INT-32-201211	Employee	Private Enterprise	Group B

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